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Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

AEROQUIP-VICKERS, INC., AND SUBSIDIARIES,
f/k/a Trinova Corporation and Subsidiaries
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether in discharging its responsibility to determine whether a Tax Court opinion is "in accordance with law" under 26 U.S.C. §7482(c)(1), a court of appeals should defer to an informal ruling of the Commissioner of Internal Revenue, which the full Tax Court had found could not be reconciled with the language of a legislative Treasury regulation.

RULES 14.1 AND 29.6 STATEMENT

Aeroquip-Vickers, Inc. (the parent company of Aeroquip-Vickers, Inc., and Subsidiaries, formerly known as Trinova Corporation and Subsidiaries), is a wholly owned subsidiary of the Eaton Corporation. The Eaton Corporation is a publicly-traded company on the New York Stock Exchange.

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CITATIONS OF OFFICIAL AND UNOFFICIAL REPORTS

The opinion of the U.S. Court of Appeals for the Sixth Circuit (App., *infra*, 1a-40a) is reported at 347 F.3d 173. The opinion of the Tax Court (App., *infra*, 42a-67a) is reported at 108 T.C. 68.

BASIS FOR JURISDICTION

The Tax Court had jurisdiction pursuant to sections 6214(a) and 7442 of the Internal Revenue Code (26 U.S.C.) (I.R.C.). The Tax Court entered a final decision on October 1, 2001. (App., *infra*, 68a-69a.) The court of appeals had jurisdiction under I.R.C. §7482. The judgment of the court of appeals was entered on October 20, 2003, and a timely petition for panel rehearing and for rehearing en banc was denied on January 21, 2004. (App., *infra*, 41a.) The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES, REGULATIONS, AND RULINGS INVOLVED IN THE CASE

The relevant provisions of I.R.C. §§38, 46, 47, and 7482, 26 C.F.R. §1.1502-3(f) (Treas. Reg.), and Rev. Rul. 82-20 are reprinted in the appendix to this petition at 70a-138a.

STATEMENT OF THE CASE

1. The Sixth Circuit's (2-1) judgment challenged here reversed a fully reviewed (effectively "en banc") decision of the Tax Court that had reiterated its previously stated view that an informal ruling by the Commissioner of Internal Revenue could not be reconciled with the language of a Treasury Department regulation. The Tax Court's decision

found the taxpayers entitled to retain certain investment tax credits that, it concluded, the Treasury regulation expressly promised them. That regulation having been adopted after notice and comment, the Tax Court concluded that the Commissioner could not change the regulation's application by a simple informal ruling.

This judgment came before the Sixth Circuit under I.R.C. §7482, which provides:

> (a) Jurisdiction.
>
> > (1) In general. The United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.
>
> . . .
>
> (c) Powers.
>
> > (1) To affirm, modify, or reverse. Upon such review, such courts shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require.
>
> . . .

The Sixth Circuit's opinion does not address whether the Tax Court's decision was "in accordance with law."

2. The underlying dispute in this matter concerns whether a corporation must repay or "recapture" investment tax credits taken on certain business assets under former I.R.C. §38 ("section 38 property") when it transfers those assets within a consolidated group and later transfers the stock of the consolidated group member to a third party. Ordinarily, a disposal of assets would require the taxpayer to recapture these credits and, correspondingly, pay additional tax. However, the rules are altered in the consolidated group context. The consolidated return regulations were promulgated in 1966 in accordance with specific congressional direction, I.R.C. §1502. Particularly, Treas. Reg. §§1.1502-3(f)(2)(i) and 1.1502-3(f)(3)(Ex. 5)[1] address situations in which section 38 property is transferred among the members of a consolidated group, or by exchange of stock. Treas. Reg. §1.502-3(f)(2)(i) provides in pertinent part that –

> . . . a transfer of section 38 property from one member of the group to another member of such group during a consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1). If such section 38 property is disposed of, or otherwise ceases to be section 38 property . . . with respect to the **transferee**, before the close of the estimated useful life . . ., then section 47(a)(1) or (2) shall apply to the **transferee** with respect to such property (determined by taking into account the period of use, qualified investment, other disposition, etc. of the transferor). Any increase in the tax due to the application of section 47(a)(1) or (2) shall be added to

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[1] Treas. Reg. §1.1502-3(f) was proposed in October, 1965. Notice of Proposed Rulemaking, 30 F.R. 190 (Oct. 1, 1965). In the Notice of Proposed Rulemaking, the public had the opportunity to submit written comments or suggestions and comment orally at a public hearing regarding the proposed regulations. *Id.* Treas. Reg. §1.1502-3(f) was adopted, without amendment, in September, 1966. T.D. 6894, 1966-2 C.B. 362.

> the tax liability of the **transferee** (or the tax liability of a group, if the transferee joins in the filing of a consolidated return) [Emphasis added]

Thus, Treas. Reg. §1.1502-3(f)(2)(i) imposes specialized obligations on consolidated group members that choose both to file as a group and to transfer section 38 property within the group. There is no exception in the regulations. The regulations test the transferee to see if it must recapture the investment tax credits and whether such recapture may be reported on either the transferee's separate return (if the transferee has left the group) or the consolidated group return (if still a member of that or any subsequent consolidated group). Thus, the transfer of property to a "transferee" within the consolidated group is not a "recapture event" for the entity making the transfer, the transferor; rather, any recapture obligation moves to the transferee with the transfer.

The concepts of the regulations are illustrated in five examples in Treas. Reg. §1.1502-3(f)(3). One directly applicable is Example 5. There, the parent (P), subsidiary (S), and the transferee-corporation (T) file a consolidated return. In that same year, the subsidiary places in service section 38 property. In the following year, P, S, and T file a consolidated return, and S sells the section 38 property to T. Then, in the next year, "P sells all the stock of T to a third party. Such sale will not cause section 47(a)(1) [*i.e.*, recapture] to apply." Treas. Reg. §1.1502-3(f)(3) (Ex. 5) (emphasis added). In other words, neither the transfer of section 38 property nor the transfer of S's stock will cause S, which originally claimed the investment tax credits, to pay additional tax. The potential liability will be that of T individually or as part of T's new consolidated group with the third party.

Sixteen years after the promulgation of these legislative regulations, the Commissioner issued Revenue Ruling 82-20, which stated that, when the transfer of property "is a step in the planned transfer of the property outside the group, section 1.1502-3(f)(2)(i) of the regulations does not apply." The

notice and comment procedures used in promulgation of Treas. Reg. §1.1502-3(f) were not followed in issuing this Revenue Ruling, and the text of Treas. Reg. §1.1502-3(f) was not (and never has been) amended.

3. The particular facts of this dispute may be summarized as follows. Aeroquip-Vickers, Inc., operating as the Libbey-Owens-Ford Company at the time ("LOF"),[2] transferred its glass manufacturing division to a wholly owned subsidiary, LOF Glass, Inc. ("LOF Glass"), in 1986. The transferred division included all assets, liabilities, and tax attributes relating to the glass manufacturing business, including section 38 property for which LOF had previously claimed investment tax credits. Approximately two months later, LOF transferred all of the stock of LOF Glass to one of LOF's shareholders, Pilkington Holdings ("Pilkington"), in exchange for Pilkington's shares in LOF. Pilkington continued to operate LOF Glass's manufacturing business after it acquired the shares of stock.

4. As the Commissioner stipulated in the later Tax Court proceedings, the transaction between LOF and Pilkington was a tax-free corporate reorganization (or "split-off") pursuant to I.R.C. §368(a)(1)(D). LOF and LOF Glass were engaged in the active conduct of a trade or business for at least five years prior to the transaction; when Pilkington became LOF Glass's owner, LOF Glass's business continued uninterrupted. *See* I.R.C. §§355(a), (b). (App., *infra*, 37a-38a.)

5. Relying on Treas. Reg. §1.1502-3(f)(2)(i) and Treas. Reg. §1.1502-3(f)(3)(Ex. 5), LOF (as Trinova) treated the split-off of LOF Glass to Pilkington as not causing a "disposition" of its section 38 property that would have required it to "recapture" the investment tax credits it had

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[2] LOF changed its name to "Trinova Corporation" by the time of the Tax Court Opinion and changed its name to "Aeroquip-Vickers, Inc.," since the Tax Court's Opinion. (App., *infra*, 1a, 4a-5a, 43a.)

claimed on purchasing that property. Because LOF transferred the glass division to LOF Glass within its consolidated group, LOF Glass was obligated as "transferee" to keep and use the section 38 property in its trade or business. So long as LOF Glass continued to use the section 38 property in its trade or business, even after its stock was transferred to Pilkington, the regulations envision no occasion for "recapture."

Although conceding the good faith and legitimate business purpose of the LOF reorganization, and stipulating to LOF Glass's continuing productive use of the assets in question, the Commissioner disagreed with LOF's tax treatment of the section 38 property. Relying on Rev. Rul. 82-20, the informal ruling he had published without notice and comment sixteen years after the Treasury regulation, he found the language of the Treasury regulation inapplicable. He also relied on *Salomon, Inc. v. United States*, 976 F.2d 837 (2d Cir. 1992), and *Walt Disney, Inc. v. Commissioner*, 4 F.3d 735 (9th Cir. 1993), *rev'g* 97 T.C. 221 (1991), courts of appeals opinions upholding similar reasoning on the ground that Rev. Rul. 82-20's approach to the regulation was entitled to "great deference."

Petitioner brought an action in Tax Court challenging this position, and, in February 1997, the full Tax Court (Tannenwald, J. (deceased)), held for the taxpayer, 11-6. *Trinova Corp. v. Commissioner*, 108 T.C. 68 (1997) (App., *infra*, 42a-67a.) As it had previously in *Disney*, 97 T.C. 221, the Tax Court considered the matter settled by the text of Treas. Reg. §1.1502-3(f)(2)(i) and Treas. Reg. §1.1502–3(f)(3) (Ex. 5), finding nothing there that could support Rev. Rul. 82-20's interpretation. (App., *infra*, 51a-53a.) The Tax Court disagreed with, and, because of the Commissioner's stipulation, distinguished factually, both *Salomon* and *Disney*. The Tax Court determined that neither the transfer of section 38 property from LOF to LOF Glass as a consolidated group member, nor the subsequent transfer of LOF Glass's stock to

Pilkington, subjected LOF (as the transferor) to recapture of its investment tax credits.[3] (App., *infra*, 52a, 54a.)

6. A divided Sixth Circuit reversed the Tax Court on October 30, 2003. The majority (Judge Julia S. Gibbons writing) did not undertake to explain why the Tax Court's judgment was "not in accordance with law." It instead referred to Rev. Rul. 82-20 and, preferring ostensible circuit court uniformity over the Tax Court's expertise, relied on the *Salomon* and *Disney* decisions and the "great deference" that they granted the revenue ruling. (App., *infra*, 8a-14a.) Despite the Commissioner's stipulated concession that, among other things, the "individual steps of the [LOF/Pilkington] transaction had a valid business purpose," and that the LOF/Pilkington transaction was "not used principally as a device for the distribution of the earnings and profits," the Sixth Circuit further suggested that the end result of the transaction constituted an improper tax avoidance motive. (App., *infra*, 17a, 37a.)

Judge Eric L. Clay's 23-page dissent maintained that the Sixth Circuit should have affirmed the expert judgment of the Tax Court.

> This opinion is noteworthy because it involves a three-judge panel of the Court of Appeals reversing (by a two-to-one vote) a "fully reviewed" (effectively "en banc") eleven-to-six decision by the United States Tax Court, which handles only complex tax disputes and consists of seventeen eminent jurists who specialize exclusively in tax

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[3] For a more detailed discussion of the disputes over the Commissioner's informal ruling, Rev. Rul. 82-20, and the procedural history of the related cases, see MARTIN D. GINSBERG AND JACK S. LEVIN, MERGERS, ACQUISITIONS, AND BUYOUTS, ¶1002.1.1.4 (Dec. 2003). *See also* BORIS I. BITTKER AND JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS & SHAREHOLDERS, ¶13.42[3][b] n.398 (2003); ANDREW J. DUBROFF ET AL., FEDERAL INCOME TAXATION OF CORPORATIONS FILING CONSOLIDATED RETURNS - SECOND EDITION, § 43.01[9] n.113 (2004).

> law. An overwhelming majority of the Tax Court found Commissioner's Revenue Ruling unpersuasive, although two of three judges of this Court find the Revenue Ruling compelling--in part because Commissioner drafted the regulation. Commissioner is also a party to this dispute; in fact, the IRS seeks to collect millions of dollars. The Tax Court's experts have no stake in the outcome.

(App., *infra*, 18a-19a.)

The dissent also noted that the court's opinion was directly contrary to this Court's precedent, namely *United States v. Mead Corp.*, 533 U.S. 218 (2001). (App., *infra*, 18a.) The dissent objected that the panel majority failed to apply the proper standard of deference to an informal revenue ruling and instead relied on the "antiquated," "distinguishable and outdated" (App., *infra*, 24a-25a) decisions in *Salomon* and *Disney* giving "great deference" to Rev. Rul. 82-20, but pre-dating this Court's decision in *Mead*. (App., *infra*, 24a-26a.)

A timely petition for rehearing and rehearing en banc was denied on January 21, 2004. (App., *infra*, 41a.)

REASONS FOR GRANTING THE PETITION

I. The Courts of Appeals Are in Conflict as to the Level of Respect Owed to the Tax Court's Interpretations of the Internal Revenue Code and, Most Importantly, the Treasury Regulations.

Internal Revenue Code §7482, which frames the review-standard problem presented in this case, was enacted in response to this Court's decision in *Dobson v. United States*, 320 U.S. 489 (1943).[4] Unfortunately, the statute's two

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[4] Congress amended I.R.C. §1141(a) (1939) in ch. 646, §36, 62 Stat. 869, 991 (1948). Section 1141(a) corresponds with the current I.R.C. §7482(a). For a history of the development of the Tax Court and the *Dobson* doctrine, see David F. Shores, *Deferential Review of Tax Court Decisions: Dobson Revisited*, 49 TAX LAW. 629 (1996), and, for a contrary view,

principal statements on the question of review look in opposing directions. Under I.R.C. §7482(a), "[t]he United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury. . . ." However, under I.R.C. §7482(c)(1), "courts shall have power to affirm or, **if the decision of the Tax Court is not in accordance with law**, to modify or to reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require" (emphasis added). Subsection (a) suggests that a judgment even by the full Tax Court has no greater claim to deference from a court of appeals than the judgment of any single district court; subsection (c)'s language points in the direction of giving the Tax Court's judgments special status.

This Court's dicta are also divided. When this Court first addressed the meaning of I.R.C. §7482, it explained the amendment to I.R.C. §7482(a) as follows:

> The purpose of the 1948 legislation was to remove from the law the favored position (in comparison with District Court and Court of Claims rulings in tax matters) enjoyed by the Tax Court under this Court's ruling in *Dobson v. Commissioner*, 320 U.S. 489. *Cf.* note 11, *supra. See Grace Bros., Inc., v. Commissioner*, 173 F.2d 170, 173.

Commissioner v. Duberstein, 363 U.S. 278, 291 n.13 (1960). Subsequently, in a case touching upon I.R.C. §7482(c)(1), this Court said that, "in reviewing a Tax Court decision, the duty of the court of appeals is to consider whether the Tax Court committed error." *Commissioner v. McCoy*, 484 U.S. 3, 6 (1987) (per curiam). There was in fact no need to address the Tax Court's arguably special status as a reviewer of tax law administration in *Duberstein*; the Court was required there to

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Steve R. Johnson, ***The Phoenix and the Perils of the Second Best: Why Heightened Appellate Deference to Tax Court Decisions is Undesirable***, 77 OR. L. REV. 235 (1998).

decide *only* what change Congress had made respecting the review of Tax Court findings *of fact*. The Court did not have to hold, and properly avoided saying, whether the Tax Court's expertise, unique responsibility, and national jurisdiction gave its findings on issues of law or, especially, law-application any force for a reviewing court. That is the question presented by this case.

The courts of appeals have struggled with what I.R.C. §7482 means in this regard. Some have determined that the Tax Court is due some level of respect beyond that of a district court, going so far as to suggest a *presumption* that the Tax Court correctly applied the law. *See, e.g., Vukasovich v. Commissioner*, 790 F.2d 1409, 1411-13 (9th Cir. 1986). Others, like the Sixth Circuit here, have treated the Tax Court as if it were just another District Court for these purposes – giving its findings on law-application and the possible interpretation of Treasury regulations no weight, and instead requiring substantial deference to the Commissioner's views. *See, e.g., Geisinger Health Plan v. Commissioner*, 985 F.2d 1210 (3d Cir. 1993), *rev'g*, 100 T.C. 394 (1993). In many instances, the courts of appeals go no further in discussing the standard of review to apply in cases coming from the Tax Court than to say section 7482 subjects the Tax Court's factual findings to a clearly erroneous standard and the Tax Court's interpretations of law to review de novo.[5] In some

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[5] *See, e.g., State Police Ass'n v. Commissioner*, 125 F.3d 1, 5 (1st Cir. 1997); *Madison Recycling Assoc. v. Commissioner*, 295 F.3d 280, 285 (2d Cir. 2002); *ACM Partnership v. Commissioner*, 157 F.3d 213, 245 (3rd Cir. 1998); *Waterman v. Commissioner*, 179 F.3d 123, 126 (4th Cir. 1999); *Commissioner v. Brookshire Bros. Holding, Inc.*, 320 F.3d 507, 509 (5th Cir. 2003); *Hospital Corp. of America & Subs. v. Commissioner*, 348 F.3d 136, 140 (6th Cir. 2003); *Seggerman Farms, Inc. v. Commissioner*, 308 F.3d 803, 805 (7th Cir. 2002); *Oren v. Commissioner*, 357 F.3d 854, 857 (8th Cir. 2004); *Vukasovich, Inc. v. Commissioner*, 790 F.2d 1409, 1411-13 (9th Cir. 1986); *Lovejoy v. Commissioner*, 293 F.3d 1208, 1209 (10th Cir. 2002); *Bone v. Commissioner*, 324 F.3d 1289, 1293 (11th Cir. 2003); *Del Commercial Properties v. Commissioner*, 251 F.3d 210, 213 (D.C. Cir. 2001).

cases, the courts of appeals state explicitly that "no deference" or "no special deference" is owed the Tax Court's conclusions of law. *See, e.g., Madison Recycling Assoc. v. Commissioner*, 295 F.3d 280, 286 (2d Cir. 2002) (espousing a "no deference" standard); *Horton v. Commissioner*, 33 F.3d 625, 631 n.10 (6th Cir. 1994) ("we owe no particular deference to the Tax Court on a question of law. . .") (citations omitted); *Hackl v. Commissioner*, 335 F.3d 664, 666 (7th Cir. 2003) ("we owe no special deference to the Tax Court on a legal question. . ."); *Exacto Spring Corp. v. Commissioner*, 196 F.3d 833, 838 (7th Cir. 1999) ("we owe no deference to the Tax Court's statutory interpretations, its relation to us being that of a district court to a court of appeals, not that of an administrative agency to a court of appeals") (citations omitted); *Best Life Assurance Co. v. Commissioner*, 281 F.3d 828, 830-31 (9th Cir. 2002) ("we give no special deference to the Tax Court's decision") (citations omitted); *Estate of Caporella v. Commissioner*, 817 F.2d 706, 708 (11th Cir. 1987) (comparing review of Tax Court legal conclusion to no "substantial deference" to district court interpretations).

In contrast, on other occasions, the courts of appeals invoke the "special expertise" of the Tax Court in interpreting the tax laws of the United States. *See, e.g., Horton v. Commissioner*, 33 F.3d 625, 631 (6th Cir. 1994) ("we find it noteworthy that *sixteen* out of nineteen judges on that court agreed that the Hortons' punitive damages award should be excludable") (citation omitted); *InverWorld, Ltd. v. Commissioner*, 979 F.2d 868, 876 (D.C. Cir. 1992) (looking to Tax Court expertise for guidance); *Estate of Schnack v. Commissioner*, 848 F.2d 933, 935 (9th Cir. 1988) ("deference to the Tax Court's expertise on narrow technical issues may be appropriate in some cases. . .") (citation omitted); *Guy F. Atkinson Co. v. Commissioner*, 814 F.2d 1388, 1391 (9th Cir. 1987) ("Tax Court's opinions bearing on the Internal Revenue Code are entitled to deference because of its special expertise in the field")(citation omitted); *La Bow v. Commissioner*, 763 F.2d 125, 130 (2d Cir. 1985) ("[t]he significance of the stay we leave to the Tax Court on remand. This is an area of law

where Tax Court expertise may be useful in explication and we ordinarily give that expertise deference"); *Yarbro v. Commissioner*, 737 F.2d 479, 483 (5th Cir. 1984) ("the Tax Court, with its own expertise, has accepted that interpretation").

Few cases have examined the interplay between I.R.C. §7482(a)(1) and I.R.C. §7482(c)(1). The Ninth Circuit, in an expansive discussion of the standard of review of a Tax Court decision, concluded, however, that "[a] general rule of special deference to the Tax Court is inappropriate although its judgments in its field of expertise are always accorded a presumption that they correctly apply the law." *Vukasovich, Inc.*, 790 F.2d at 1413. Various other courts of appeals have adopted a standard similar to the *Vukasovich* decision. *See, e.g., Ann Jackson Family Found. v. Commissioner*, 15 F.3d 917, 920 n.9 (9th Cir. 1994) (parties disputing deference to Tax Court expertise because of conflicting law); *Smith v. Commissioner*, 926 F.2d 1470, 1474 (6th Cir. 1991) (citing "not in accordance with law" language from I.R.C. §7482(c)(1)); *Cloughtery Packing Co. v. Commissioner*, 811 F.2d 1297, 1299 (9th Cir. 1987) ("Although the Tax Court's judgments in its filed [sic] of expertise are accorded a presumption that they correctly apply the law, we do not apply a rule of special deference to its decisions."); *Estate of Franklin v. Commissioner*, 544 F.2d 1045, 1048 n.3 (9th Cir. 1976) ("As stated in *Lundgren v. Commissioner*, 376 F.2d 623, 627 (9th Cir. 1967), our duty is to decide 'whether the Tax Court correctly applied the statute to the factual situation found by the Tax Court.'"); *ABKCO Industries, Inc. v. Commissioner*, 482 F.2d 150 (3rd Cir. 1973) (upholding Tax Court unless appellant shows Tax Court decision was wrong). The courts of appeals have not been consistent in the application of the "presumption of correctness" standard stated in *Vukasovich*. In, for example, *Schroeder v. Commissioner*, 831 F.2d 856, 858 (9th Cir. 1987), the Ninth Circuit recognized the intra-circuit conflict as well.

Our case law conflicts on the question of whether we should accord to the Tax Court special deference in deciding questions of law under the Internal Revenue Code. In *Vukasovich*, we rejected any general rule of special deference to the legal conclusions of the Tax Court. 790 F.2d at 1411-13. We have not consistently followed *Vukasovich*, however. In the earlier case of *Magneson v. Commissioner*, 753 F.2d 1490, 1493 (9th Cir. 1985) (disapproved of in *Vukasovich*), we noted that the Tax Court's "opinions are entitled to respect because of its special expertise in the field." *Id.* We recently followed *Magneson* in *Graham v. Commissioner*, 822 F.2d 844, 848 (9th Cir. 1987).

II. In Resolving These Conflicts and the Tension between Sections 7482(a)(1) and 7482(c)(1), this Court Could Assure Appropriate Recognition to the Tax Court's Unique Position as a Court of National Jurisdiction to Ensure Conformity of Informal Revenue Rulings to the Law.

A. The Tax Court Is Responsible for the Overwhelming Majority of Tax Cases.

While a taxpayer has a choice of forums to litigate Federal tax issues, the Tax Court hears the vast majority of them. In the last few years, the percentage of tax cases heard in the Tax Court has increased significantly; the Tax Court heard 69% of the tax cases in 1999, 63% of the tax cases in 2000, 75% of the tax cases in 2001, and 87% of the tax cases in 2002. *See* INTERNAL REVENUE SERVICE, DATA BOOK 1999 30; INTERNAL REVENUE SERVICE, DATA BOOK 2000 30; INTERNAL REVENUE SERVICE, DATA BOOK 2001 30; INTERNAL REVENUE SERVICE, DATA BOOK 2002 36. In addition, the number of new Tax Court cases every year is significant. Cases filed in the Tax Court in 2003, 2002, 2001, 2000, and 1999 are 21,444, 17,787, 15,440, 13,676, and 20,302, respectively. *See* STATISTICS AND REPORTS SECTION,

UNITED STATES TAX COURT, FISCAL YEAR STATISTICAL INFORMATION (2004). Even though most of the tax cases docketed in the Tax Court settle, the Tax Court issues a number of substantive opinions each year. The Chief Judge of the Tax Court categorizes such opinions to be published in the official Tax Court reporter ("TC Opinions") or released as Tax Court memorandum opinions ("TCMs"). The TC Opinions are generally recognized as binding precedent on all Tax Court judges, whereas TCMs generally do not have precedential effect. The number of TCMs released by the Tax Court each year far surpasses the number of TC Opinions.[6] Of the 36 substantive TC Opinions issued last year, only four cases were fully reviewed by all of the judges of the Tax Court.

B. The Tax Court Is Well Positioned to Provide an Important Check on the Commissioner's Issuance of Informal Revenue Rulings.

The Commissioner relies heavily on rulemaking to administer the tax laws. This rulemaking takes two forms: the promulgation of Treasury regulations after notice and comment; and the issuance of informal guidance, primarily "revenue rulings." Treasury regulations, when the Commissioner uses them, are binding law. Revenue rulings, his more frequent tool, are not. *See, e.g., Dixon v. United States*, 381 U.S. 68, 73 (1965) ("The Commissioner's rulings have only such force as Congress chooses to give them, and Congress has not given them the force of law."); *Byrum v. United States*, 440 F.2d 949, 952-953 (6th Cir. 1971) (revenue rulings "do not have the force of law"); *Stubbs, Overbeck & Assoc.*, 445 F.2d 1142, 1146-47 (5th Cir. 1971) (same); *American Stores Co. v. American Stores Co. Retirement Plan*,

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[6] For example, in the fiscal year ending September 30, 2003, the Tax Court issued 348 TCMs and only 36 TCs. These numbers have been relatively consistent for the last five years. Similarly, in 1997, the year of the decision in this case, the Tax Court issued 45 TC Opinions, 566 TCMs, and seven fully reviewed TC Opinions.

928 F.2d 986, 994 (10th Cir. 1991) (same); Treas. Reg. §601.601(d)(2)(v)(d) ("Revenue Rulings published in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose."); INTERNAL REVENUE MANUAL, ¶8.14.1.1 (same).

The Commissioner issues numerous revenue rulings each year and intends to issue substantially more. *See* SHERYL STRATTON, *IRS Official Sketches Agenda for Office of Chief Counsel*, 2002 TAX NOTES TODAY 48-4 (2002).[7] Last year alone, the Commissioner issued 128 revenue rulings.[8] The Commissioner increased the number of revenue rulings released in each of the five prior years as follows: 58 in 1999,[9] 59 in 2000,[10] 66 in 2001,[11] and 91 in 2002.[12] Significantly, the Commissioner may (and does) withdraw revenue rulings at any time, for any reason. In 2003, for example, the Commissioner revoked 13 revenue rulings.[13]

By comparison, in 1999 through 2002, the Treasury Department adopted an average of 59 regulations per year.[14]

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[7] In a speech to the Federal Bar Tax Law Conference on March 11, 2002, IRS Chief Counsel B. John Williams acknowledged that issuing formal regulations is a slow process, comparing regulations to sourdough, stating that if pieces of the sourdough are not cut off and baked, the dough grows, and soon there is a dough-filled kitchen. Sheryl Stratton, *IRS Official Sketches Agenda for Office of Chief* Counsel, 2002 TAX NOTES TODAY 48-4 (2002).

[8] Rev. Rul. 2003-128, 2003-52 I.R.B. 1247.

[9] Rev. Rul. 1999-58, 1999-2 C.B. 701.

[10] Rev. Rul. 2000-59, 2000-2 C.B. 593.

[11] Rev. Rul. 2001-66, 2001-2 C.B. 637.

[12] Rev. Rul. 2002-91, 2002-2 C.B. 991.

[13] 2003-27 I.R.B. iv-vi; 2003-52 I.R.B. iv-ix; 2003-1 I.R.B. iv-vi; *see also* 2002-26 I.R.B. iv-vi; 2002-1 I.R.B. iv-v; 2001-27 I.R.B. iv-v; 2001-1 I.R.B. iii; 2000-27 I.R.B. iv-v; 2000-1 I.R.B. iii-iv; 1999-27 I.R.B. 13.

[14] 1999-1 C.B. iii, iv; 1999-2 C.B. iii, iv; 2000-1 C.B. iv, v; 2000-2 C.B. iv; 2001-1 C.B. v; 2001-2 C.B. v; 2002-1 C.B. v; 2002-2 C.B. v.

In 2003, however, the number of regulations adopted by the Treasury Department fell to 36, which is less than a third of the revenue rulings issued in 2003.[15] Lower courts and scholars have noted a disturbing divergence generally between administrative agency use of formal rulemaking and agency use of informal guidance in recent years. Thus, reports Professor Todd Rakoff about the Food and Drug Administration's experience,

> If we compare the mid-1990s with the late 1970s or early 1980s, we find that the number of FDA regulations adopted each year in accordance with the APA's rulemaking procedures declined by about fifty percent. By contrast, since the start of this decade there has been a striking increase in the number of FDA-issued documents intended to give guidance to the regulated industry but not adopted through public procedures. The rate per year for the 1990s is about four hundred percent greater than the rate for the 1980s.[16]

Recent expressions by the D.C. Circuit reflect a growing concern about this general issue; thus, in a case coming to it from the EPA, one panel of that court observed –

> The phenomenon we see in this case is familiar. Congress passes a broadly worded statute. The agency follows with regulations containing broad language, open-ended phrases, ambiguous standards and the like. Then as years pass, the agency issues circulars or guidance or memoranda, explaining, interpreting, defining and often expanding the commands in the regulations. One guidance document may yield another and then another and

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[15] 2003-52 I.R.B. iii.

[16] Todd D. Rakoff, *The Choice Between Formal and Informal Modes of Administrative Regulation*, 52 ADMIN. L. REV. 159, 168 (2000). *See also* Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 ADMIN. L. REV. 59 (1995).

> so on. Several words in a regulation may spawn hundreds of pages of text as the agency offers more and more detail regarding what its regulations demand of regulated entities. Law is made, without notice and comment, without public participation, and without publication in the Federal Register or the Code of Federal Regulations. With the advent of the Internet, the agency does not need these official publications to ensure widespread circulation; it can inform those affected simply by posting its new guidance or memoranda or policy statement on its web site. An agency operating in this way gains a large advantage. "It can issue or amend its real rules, i.e., its interpretative rules and policy statements, quickly and inexpensively without following any statutorily prescribed procedures." Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 ADMIN. L. REV. 59, 85 (1995). . . . The agency may also think there is another advantage--immunizing its lawmaking from judicial review.

Appalachian Power Co. v. Environmental Protection Agency, 208 F.3d 1015, 1020 (D.C. Cir. 2000) (footnote omitted). *See also Paralyzed Veterans of America v. D.C. Arena L.P.*, 117 F.3d 579, 584 (D.C. Cir. 1997) ("A substantive regulation must have sufficient content and definitiveness as to be a meaningful exercise in agency lawmaking. It is certainly not open to an agency to promulgate mush and then give it concrete form only through subsequent less formal 'interpretations.'")

The Tax Court has had significant experience with the Commissioner's reliance on informal rulings to "interpret" both the Internal Revenue Code and the Treasury regulations. Over time, the Tax Court has been persuaded that the Commissioner has sometimes attempted, as here, to give the Code and the regulations interpretations that their terms cannot support, or in other ways to use the informal guidance

process to unfair advantage. For example, in another dispute arising during the pendancy of the appeal in this case, the Commissioner attempted to disavow a prior interpretative ruling that happened not to fit his theory of the case, arguing in *that* context that his interpretative rulings were merely advisory and not binding upon him—to the Tax Court's surprise. *Electronic Arts, Inc. v. Commissioner*, 118 T.C. 226, 278 n.13 (2002).[17] The government's desire to distance itself from inconvenient revenue rulings is not a recent occurrence. *See, e.g., Dixon v. United States*, 381 U.S. 68 (1965) (revenue ruling withdrawn, replaced with another with retroactive effect); *Silco, Inc. v. United States*, 779 F.2d 282, 287 (5th Cir. 1986) (two revenue rulings favorable to taxpayer disavowed); *Nissho Iwai Am. Corp. v. Commissioner*, 89 T.C. 765, 778 (1987); *Beneficial Foundation, Inc. v. United States*, 8 Cl. Ct. 639, 644-645 (1985).

When the Commissioner has no other authority to support a weak-litigating position, he also has been known to bootstrap his position by issuing "well-timed" revenue rulings and then arguing "deference." *See, e.g., Fribourg Navigation Co. v. Commissioner*, 383 U.S. 272 (1966) (revenue ruling issued on eve of trial rejected); *AMP, Inc. v. United States*, 185 F.3d 1333, 1338-39 (Fed. Cir. 1999) ("revenue ruling issued at a time when the I.R.S. is preparing to litigate is often self-serving and not generally entitled to deference"); *General Dynamics Corp. v. Commissioner*, 108 T.C. 107, 120 (1997) ("revenue rulings are generally not afforded any more weight than . . . a position on brief. . . especially [when] . . not publish[ed] . . . prior to this controversy"); *Tandy, Inc. v. Commissioner*, 92 T.C. 1165, 1170 (1989) (revenue ruling was "a thinly veiled attempt to influence this litigation"); *Ludwig v. Commissioner*, 68 T.C. 979, 986 n. 4 (1977)

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[17] Because of *Electronic Arts*, the IRS Chief Counsel issued a notice to Chief Counsel attorneys that they may no longer take positions in litigation contrary to revenue rulings. Chief Counsel Notice 2002-043 (Oct. 17, 2002); *clarified and superceded by* Chief Counsel Notice 2003-014 (May 8, 2003).

("courts have not looked with favor upon bootstrapping revenue rulings issued shortly prior to the initiation of litigation").

Interpretative rulings have undoubted importance for administration, as this Court has recognized in *Mead*. Yet avoidance of the excesses that have contributed to these judicial expressions suggests the profound importance of effective judicial checks on the fit between regulations adopted after notice and comment, and informal interpretative rules. The Tax Court is particularly well situated for that function. The Commissioner's use and abuse of revenue rulings points out precisely why a Tax Court decision is entitled to an increased level of respect and consideration when the Commissioner's informal interpretations of the revenue laws are being tested against Treasury's legislative regulations. Only this Court is in a position to provide the necessary guidance to the courts of appeals to that end.

III. The Degree of Deference Courts of Appeals Owe the Tax Court's Judgments Concerning the Consistency of the Commissioner's Interpretative Rulings with Governing Law Is an Important and Undecided Question of Federal Law.

In this case, a Tax Court opinion emanating from seventeen judges of that court considered the language of the operative Treasury regulations and held that the Commissioner's ruling was simply irreconcilable with it. It found, on the basis of the Commissioner's stipulations in the proceeding, that no tax avoidance motive was present. The Commissioner appealed and asserted that his informal interpretation should control. The Sixth Circuit panel majority treated only the Commissioner, not the Tax Court, as entitled to any deference. It cast aside the Tax Court's factual determinations, as if they were "clearly erroneous," despite the Commissioner's stipulations. It did not directly address why the Tax Court's interpretation was not in accordance with law. Instead, the Sixth Circuit looked primarily to the Second Circuit's *Salomon* decision and the Ninth Circuit's

Disney decision, each of which had pre-dated *Mead* and had given "great deference" to the revenue ruling. Preferring to maintain supposed circuit court uniformity (App., *infra*, 14a), the Sixth Circuit failed its obligations under I.R.C. §7482(c)(1) to respect the Tax Court's assessment of conflicts between Treasury regulations and the Commissioner's rulings, and effectively required the Tax Court to defer to the Commissioner's interpretations as it had done.

It might be argued that this Court's decisions in cases like *Martin v. Occupational Safety and Health Review Comm'n*, 499 U.S. 144 (1991), or *Thomas Jefferson University v. Shalala*, 512 U.S. 504 (1994), in fact require the Tax Court to adopt an attitude toward the Commissioner's informal rulings such as the Sixth Circuit has effectively commanded in this case. However, the interpretative issues in those cases concerned matters of policy within a range of meanings that the regulations in question concededly permitted. In this case, the Tax Court is being required to honor a meaning it has determined the regulations' language simply does not permit; specifically, the Tax Court considered the range of meanings within Treas. Reg. §1.1502-3(f) and found that there was no room for the interpretation advocated by Rev. Rul. 82-20. Determining what governing law could possibly mean is inescapably and essentially a judicial responsibility, not an administrative one; and the Tax Court is the one judicial tribunal most centrally charged and best positioned to hold the Commissioner within the constraints of legality. Imposing the Sixth Circuit's standard on the Tax Court truly arms the Commissioner to "promulgate mush" (*Paralyzed Veterans*, 117 F.3d at 584) and to defeat taxpayer expectations – expectations legitimately grounded in legislative regulations – by the most informal and unilateral of means.

Had the Sixth Circuit granted the appropriate level of respect to the Tax Court's expertise, position and responsibilities, the panel majority would have reached a contrary result.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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April 19, 2004

APPENDIX A

No. 01-2741

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

AEROQUIP-VICKERS, INC. and SUBSIDIARIES,
f/k/a Trinova Corp. and Subsidiaries,
Petitioner-Appellee,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

DECIDED: October 20, 2003

ARGUED: Frank P. Cihlar, United States Department of Justice, Appellate Section, Tax Division, Washington, DC, for Appellant.

Thomas V.M. Linguanti, Baker & McKenzie, Chicago, IL for Appellee.

ON BRIEF: Frank P. Cihlar, Joel L. McElvain, United States Department of Justice, Appellate Section, Tax Division, Washington, D.C., for Appellant.

Thomas V.M. Linguanti, Frederick E. Henry III, Robert S. Walton, Baker & McKenzie, Chicago, Illinois, for Appellee.

Before CLAY and GIBBONS, Circuit Judges; DUGGAN, District Judge.

GIBBONS, Circuit Judge.

In 1986, petitioner-appellee Aeroquip-Vickers, Inc. (formerly known as Trinova Corporation, and operating as the Libbey-Owens-Ford Company (LOF) at the time), transferred all of its assets relating to a glass manufacturing business,

including property for which it had previously claimed investment tax credits (ITCs) under former 26 U.S.C. § 38 (Section 38 property), into a wholly-owned subsidiary, LOF Glass, Inc. (LOF Glass). LOF then transferred LOF Glass to one of its shareholders, Pilkington Holdings, in return for Pilkington Holdings' shares in LOF. LOF treated this transaction as a corporate reorganization under 26 U.S.C. § 368(a)(1)(D) and accordingly did not recognize any gain or loss from the exchange on the consolidated federal income tax return for 1986 that it filed together with LOF Glass. LOF also did not report any recaptured ITCs from the transaction, as would be required by former 26 U.S.C. § 47(a)(1) upon the disposition of Section 38 property before the end of the property's estimated useful life.

In 1993, the Commissioner of Internal Revenue (CIR) asserted a deficiency against LOF for LOF's failure to include ITC recapture in income under former 26 U.S.C. § 47(a)(1) on its 1986 consolidated tax return. Trinova petitioned the United States Tax Court for a redetermination of the deficiency. The Tax Court held that neither the transfer of the property from LOF to LOF Glass nor the change in ownership of LOF Glass was a disposition of Section 38 property under 26 U.S.C. § 47, and that Trinova thus had no recapture obligations. CIR appealed. For the reasons set forth below, we reverse the decision of the Tax Court.

I.

The facts are not disputed. Pursuant to Tax Court Rule 91(a), the parties submitted a Stipulation of Facts, which the Tax Court summarized as follows:

> Petitioner, an accrual basis taxpayer . . . changed its name to Trinova from the Libbey-Owens-Ford Company (LOF) on July 31, 1986. Petitioner timely filed a consolidated Federal income tax return with certain of its subsidiaries for the years at issue with the Internal Revenue Service Center, Cincinnati, Ohio, or the Internal Revenue

Service office in Toledo, Ohio. Petitioner was engaged in the fluid power and plastics businesses and the manufacture of glass. The glass business was referred to as "LOF Glass Division."

One of LOF's largest shareholders was Pilkington Brothers (Pilkington), an English company, which owned 29 percent of petitioner's common stock through its wholly owned U.S. subsidiary, Pilkington Holdings, Inc. (Pilkington Holdings). Two of petitioner's fourteen directors were associated with Pilkington. In late 1985, Pilkington approached LOF and began negotiations concerning the possibility of acquiring the glass business.

Earlier that year, on July 25, 1985, the board of directors of LOF approved the transfer of the glass business to a wholly owned subsidiary for valid business reasons. On February 19, 1986, LOF Glass, Inc. was incorporated as a wholly-owned subsidiary of LOF. On March 6, 1986, a "Transfer and Assumption Agreement," amended on April 25, 1986, transferred to LOF Glass, Inc., all assets associated with the LOF Glass Division, including inventories and receivables, effective retroactively to February 19, 1986. These assets also included section 38 assets upon which LOF had previously claimed ITCs. Petitioner took no formal action contemplating the liquidation of LOF Glass, Inc., in the event that the acquisition by Pilkington did not take place.

On March 7, 1986, LOF, Pilkington, and Pilkington Holdings entered into an agreement, amended on April 28, 1996, whereby LOF would transfer all of its shares of LOF Glass, Inc., to Pilkington Holdings in exchange for all of the shares of petitioner held by Pilkington Holdings. On April 28, 1996, Pilkington Holdings exchanged

4,064,550 shares of LOF for the shares of LOF Glass, Inc. LOF Glass, Inc., continued to operate the glass business as a subsidiary of Pilkington Holdings and used the section 38 assets in its trade or business.

The parties have stipulated that petitioner recognized no gain or loss upon the transaction whereby its glass business was transferred to LOF Glass, Inc., pursuant to the provisions of section 351 or sections 354, 355, and 368(a)(1)(D) (except as required by such sections or section 357(c)), and that pursuant to section 355 neither petitioner nor Pilkington Holdings recognized any gain or loss upon the exchange of LOF Glass, Inc., shares for the LOF shares.

Before February 19, 1986, income, deductions, and credits with respect to the LOF Glass Division were included in petitioner's return. From February 19, 1986, through April 28, 1986, deductions and credits with respect to LOF Glass, Inc. (the subsidiary), were included as part of petitioner's consolidated return. After April 28, 1986, LOF Glass, Inc., was no longer part of petitioner, petitioner's affiliated group, or petitioner's consolidated Federal income tax return.

On its 1986 consolidated return, petitioner did not include any amount of ITC recapture with respect to the LOF Glass, Inc., section 38 assets. Respondent determined that a $ 5,718,749 ITC recapture arose from the April 1986 transaction. Petitioner does not dispute the amount of the ITC recapture. . . .

On November 26, 1993, CIR issued a notice of deficiency to Trinova, stating that Trinova had understated its tax liabilities on the consolidated income tax returns that it had filed with its subsidiaries between 1985 and 1988. On

February 18, 1994, Trinova filed a petition with the Tax Court contesting the deficiencies, including CIR's recapture of ITCs under 26 U.S.C. § 46. On February 27, 1997, the Tax Court found in favor of Trinova on the issue of the recapture of the ITCs. On October 1, 2001, the Tax Court entered a decision disposing of all claims of all parties. CIR timely filed a notice of appeal.

II.

The Tax Court's application of law to the fully stipulated record is reviewed *de novo*. *See* Friedman v. Comm'r, 216 F.3d 537, 541 (6th Cir. 2000).

Under former 26 U.S.C. § § 38 and 46, a taxpayer who acquired certain machinery and equipment for use in its trade or business (Section 38 property) was allowed a credit against its income tax liability in an amount equal to a percentage of his investment (the ITC). However, under former 26 U.S.C. § 47, the ITC was limited to property that the taxpayer used in its trade or business for most of the property's useful life. If the taxpayer disposed of Section 38 property before the end of the useful life, then the taxpayer was required to recapture the ITC and increase its tax liability. *See* 26 U.S.C. § 47(a)(1). The stated purpose of this provision was "to guard against a quick turnover of assets by those seeking multiple credit." S. Rep. No. 1881, 87th Cong., 2d Sess. 11 (1962).

Determining that Trinova was not liable for ITC recapture, the Tax Court emphasized that "the transactions herein took place in the consolidated return context." Section 1.1502-3(f)(2)(i) of the Consolidated Return Regulations (CRR) states that "a transfer of section 38 property from one member of the group to another member of such group during a consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1)." Defending the Tax Court's application of this provision to the facts in this case, Aeroquip-Vickers observes that "after [LOF] transferred the LOF Glass Division business . . . to LOF Glass including some section 38 property, LOF Glass

continued to use the section 38 property while a member of the [LOF] affiliated group," and thus asserts that the "transfer of the section 38 property to LOF Glass . . . was a non-event under section 47; there was no 'disposition' of section 38 property." In addition, Aeroquip-Vickers argues that "this non-event for section 37 purposes did not metamorphose into an ITC recapture event merely because LOF glass ultimately left the [LOF] affiliated group" since "LOF Glass continued to use the section 38 property up to and following the time that LOF Glass left the [LOF] affiliated group." Aeroquip-Vickers thus claims that "there would be no recapture event unless or until *LOF Glass* disposed of the section 38 property." (emphasis in brief).

In support of its decision, the Tax Court relied upon CRR § 1.1502-3(f)(3), which provides the following examples:

> Example (1). P, S, and T file a consolidated return for calender year 1967. In such year S places in service section 38 property having an estimated useful life of more than 8 years. In 1968, P, S, and T file a consolidated return and in such year S sells such property to T. Such sale will not cause section 47(a)(1) to apply.
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> * * *
>
> Example (3). Assume the same facts as in example (1), except that P, S, and T continue to file consolidated returns through 1971 and in such year T disposes of the property to individual A. Section 47(a)(1) will apply to the group . . .
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> * * *
>
> Example (5). Assume the same facts as in example (1), except that in 1969, P sells all the stock of T to a third party. Such sale will not cause section 47(a)(1) to apply.

The Tax Court first noted that "the mere transfer of section 38 assets within a consolidated group does not trigger recapture" and then added that Example 5 illustrated that "the transfer of the stock of [LOF Glass] to Pilkington Holdings would *not* trigger the recapture of such credit. "Trinova Corp. v. Commissioner, 108 T.C. 68, 73 (1997) (emphasis added).

CIR argues that the Tax Court erred by failing to give appropriate deference to Revenue Ruling 82-20. Revenue rulings are official interpretations by the IRS which have been published in the Internal Revenue Bulletin. 26 CFR § 601.201(a)(6). Under the facts assumed by Revenue Ruling 82-20, parent corporation P owns 100 percent of subsidiary corporation S. P and S file a consolidated federal income tax return. A and B, equal owners of P, decide to split the business into two independent corporations, one owned by A and the other owned by B. To achieve this, "P transferred all the assets of one of the businesses necessary to conduct the trade or business, including section 38 property, to S solely in exchange for additional shares in S and immediately thereafter distributed all the stock of S to A. . . . A surrendered all its stock in P as part of the transaction." Id. Revenue Ruling 82-20 states that:

> When there is no intention at the time of transfer to keep the property within the consolidated group, the transaction should be viewed as a whole and not as separate individual transactions. . . . Because the transfer of the section 38 property from P to S is a step in the planned transfer of the property outside the group, the exception in section 1.1502-3(f)(2)(i) of the regulations does not apply to this transaction. Therefore, the transfer from P to S is a disposition under section 47(a)(1) of the Code.

Id.

Rejecting CIR's position, the Tax Court concluded that "Example 5 and not Rev. Rul. 82-20 . . . provides the key to decision herein." Trinova Corp. v. Comm'r, 108 T.C. 68, 77

(1997). The Tax Court acknowledged that both the Second Circuit in Salomon Inc. v. United States, 976 F.2d 837 (2d Cir. 1992) and the Ninth Circuit in Walt Disney v. Comm'r, 4 F.3d 735 (9th Cir. 1993), cases involving "factual situations substantially similar to that involved herein," had reached the opposite conclusion. However, the Tax Court explained that

> with all due respect, we disagree with both the result and the reasoning of the Courts of Appeals. . . . We think that the fact that the transfer of the assets and the transfer of the stock occurred in the same, rather than different, taxable years does not provide a meaningful basis for distinguishing Rev. Rul. 82-20 . . . from Example 5 of the regulations. . . . We think the Courts of Appeals for the Second and Ninth Circuits accorded the ruling undue weight and that revenue rulings play a lesser role than the language of the opinions of those Courts of Appeals seems to indicate.

Trinova Corp., 108 T.C. at 76-77. The Tax Court also added that in this case CIR "has stipulated that there was a business purpose, i.e. substance, to the transfer by petitioner to [LOF Glass]." *Id.* at 78.

In Salomon, Engelhard Minerals and Chemicals Corporation (EMC) (later known as Salomon) developed a plan to separate its marketing arm and its industrial divisions into two independent companies. 976 F.2d at 838. EMC transferred the assets and liabilities of its industrial divisions to Porocel, an existing wholly owned subsidiary (later renamed Engelhard Corporation (EC)). *Id.* In return, EMC received EC stock. Id. Four days later, EMC "[spun] off" EC "by distributing all of its EC shares pro-rata to its stockholders." Id. The IRS determined that EMC would not recognize gain as a result of the transaction. Id. at 839. However, the IRS also noted that "certain of the machinery, equipment and other assets that EMC planned to transfer to EC qualified as section 38 property," and concluded that the "transfer of this property to EC followed by a spin-off to

EMC shareholders [was] a 'disposition' which triggered § 47(a) recapture." Id. at 840. Salomon brought suit to recover the recapture taxes paid. Id.

The Second Circuit concluded that Revenue Ruling 82-20 was not "unreasonable, nor inconsistent with prevailing law," and thus was "entitled to great deference." Id. at 841. The Second Circuit explained that since a direct transfer of Section 38 property was a disposition under 26 U.S.C. § 47(a)(1), "the more circuitous transfer by way of another consolidated group member should be as well." Id. at 842.

> In substance, if not in form, the direct and the circuitous transaction are the same. Each achieves a rapid transfer of section 38 property outside the group. To distinguish between them would deny economic reality. Moreover, such a holding would allow the common parent of a consolidated group, such as EMC, to move section 38 property outside the group without paying recapture taxes simply by first transferring the property to a member subsidiary and then distributing the subsidiary's stock to the third-party. Revenue Ruling 82-20's requirement of recapture under these circumstances is not unreasonable.
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> The rapidity with which these components follow one another suggest that they are, in substance, parts of one overall transaction intended to dispose of the section 38 assets outside of the consolidated group. Revenue Ruling 82-20 further solidifies this inference by positing that there is "no intention at the time of transfer to keep the property within the consolidated group." These factual circumstances, timing and intent, differ from those presented in CRR Example 5. They lead to the conclusion that the two components are steps in a larger transaction

> which, when viewed as a whole, constitutes a § 47(a)(1) "disposition."

Id. at 842 (citations omitted).

The reasoning and conclusion of the Second Circuit was subsequently adopted by the Ninth Circuit in Walt Disney. In that case, Retlaw, a predecessor of Walt Disney Inc. (Disney), developed a plan to separate its "Disney assets" (including the commercial rights to the name "Walt Disney" and two attractions at Disneyland) from its "non-Disney assets" (two television stations, a cattle ranch, and several agricultural properties), and then allow Walt Disney Productions (Productions) to acquire Retlaw (which would only retain its Disney assets). Walt Disney, 4 F.3d at 737. In order to accomplish this, Retlaw transferred its non-Disney assets, which included Section 38 property, to a newly-formed, wholly owned subsidiary called Flower Street. *Id.* In exchange, Retlaw received Flower Street common stock. Id. That same day, the Retlaw board of directors authorized the distribution of the Flower Street stock pro rata to the Retlaw shareholders, but specified that the distribution could only be made concurrently with the closing of Productions' proposed acquisition of Retlaw. Id. The actual distribution occurred fifty-nine days later, immediately following the approval of the Retlaw acquisition by Productions' shareholders and just prior to Productions' acquisition of the stock of Retlaw. Id. at 738.

Retlaw and Flower Street then filed a consolidated federal income tax return. Id. In the consolidated return, however, Retlaw did not recapture the ITCs it previously had taken on Section 38 property included among the non-Disney assets transferred to Flower Street. Id. As a result, the IRS assessed a deficiency, which Disney contested. Id. Reversing the decision of the Tax Court, the Ninth Circuit applied Revenue Ruling 82-20 and determined that Disney was required to recapture the ITC it had previously taken with respect to Section 38 property transferred by Retlaw to Flower Street. Id. at 739. The Ninth Circuit explained that

> Revenue Ruling 82-20 is not unreasonable because "in substance, if not in form, the direct and the circuitous transaction are the same" and "to distinguish between them would deny economic reality" and would allow the common parent of a consolidated group to circumvent easily the recapture requirement. Moreover, Revenue Ruling 82-20 and Example 5 of the Consolidated Return Regulations are not inconsistent because they address different situations: the latter covers situations where, due to a "meaningful time delay" between the asset transfer and the spin-off, there is "little reason to believe that the transferor corporation intends to use the transaction as a means of moving section 38 property out of the group while avoiding recapture taxes"; the former involves facts under which the transferor's initial intent to move section 38 property out of the consolidated group is undisputed.

Id. (quoting Salomon, 976 F.2d at 842) (internal citations omitted).

As the Tax Court observed, both the Second Circuit and the Ninth Circuit afforded "great deference" to Revenue Ruling 82-20. This court previously has held that "although a revenue ruling 'is not entitled to the deference accorded a statute or a Treasury Regulation,' a revenue ruling is entitled to some deference unless 'it conflicts with the statute it supposedly interprets or with that statute's legislative history or if it is otherwise unreasonable.'" CenTra, Inc. v. United States, 953 F.2d 1051, 1056 (6th Cir. 1992) (quoting Threlkeld v. Comm'r, 848 F.2d 81, 84 (6th Cir. 1988)); see also Johnson City Med. Ctr. v. United States, 999 F.2d 973, 977 (6th Cir. 1993) ("This Court accords deference to Revenue Ruling 85-74 under the standard set forth in Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467

U.S. 837, 842- 43, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984)." n1;[1] Wuebker v. Comm'r, 205 F.3d 897, 903 (6th Cir. 2000).

However, recent Supreme Court decisions limiting the Chevron doctrine have called our earlier cases into question. In Christensen v. Harris County, 529 U.S. 576, 587, 146 L. Ed. 2d 621, 120 S. Ct. 1655 (2000), the Supreme Court held that "interpretations such as those in opinion letters - like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law - do not warrant Chevron-style deference." The Court explained that such agency interpretations are entitled to respect, "but only to the extent that those interpretations have the 'power to persuade.'" *Id.* (quoting Skidmore v. Swift & Co., 323 US. 134, 140, 89 L. Ed. 124, 65 S. Ct. 161 (1944)). In United States v. Mead Corp., 533 U.S. 218, 226-27, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001), the Supreme Court emphasized that Chevron deference is appropriate only "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority" through "notice-and-comment rulemaking, or by some other indication of a comparable congressional intent." The Court added that "an agency's interpretation may merit some deference whatever its form, given the 'specialized experience and broader investigations and information' available to the agency, and given the value of uniformity in its administrative and judicial understandings of what a national law requires." Id. at 234 (quoting Skidmore, 323 U.S. at 139-40). In United

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[1] "When Congress has 'explicitly left a gap for an agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation,' Chevron, 467 U.S. at 843-844, and any ensuing regulation is binding in the courts unless procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute." United States v. Mead Corp., 533 U.S. 218, 227, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001) (explaining the application of the Chevron test).

States v. Cleveland Indians Baseball Co., 532 U.S. 200, 220, 149 L. Ed. 2d 401, 121 S. Ct. 1433 (2001), the Supreme Court declined to consider "whether the Revenue Rulings themselves are entitled to deference." However, the Court noted that the revenue rulings at issue "reflect the agency's longstanding interpretation of its own regulations," and concluded that "because that interpretation is reasonable, it attracts substantial judicial deference." Id.

When promulgating revenue rulings, the IRS does not invoke its authority to make rules with the force of law. Specifically, the IRS does not claim for revenue rulings "the force and effect of Treasury Department regulations." Rev. Proc. 89-14, 1989-1 C.B. 814. In light of the Supreme Court's decisions in Christensen and Mead, we conclude that Revenue Ruling 82-20 should not be accorded Chevron deference. Revenue rulings do, however, constitute "precedents to be used in the disposition of other cases." Rev. Proc. 89-14, 1989-1 C.B. 815. Revenue rulings also serve as "official interpretations" by the IRS of the tax laws. Treas. Reg. § 601.201(a)(6). By noting only that revenue rulings "are not entitled to the deference accorded a statute or a Treasury Regulation," without explicitly acknowledging that some deference to revenue rulings is proper, the Tax Court mischaracterized the degree of deference accorded to revenue rulings. See, e.g., Omohundro v. United States, 300 F.3d 1065, 1069 (9th Cir. 2002) (granting Skidmore deference to a revenue ruling); Del Commercial Props., Inc. v. Comm'r, 346 U.S. App. D.C. 149, 251 F.3d 210, 214 (D.C. Cir. 2001) (same); U.S. Freightways Corp. v. Comm'r, 270 F.3d 1137, 1142 (7th Cir. 2001) (same); American Express Co. v. United States, 262 F.3d 1376, 1383 (Fed. Cir. 2001) (reasoning that "in the context of tax cases, the IRS's reasonable interpretations of its own regulations and procedures are entitled to particular deference." (citing Cleveland Indians,

532 U.S. at 220)).[2] Consequently, the level of deference to be accorded to Revenue Ruling 82-20 depends upon "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." Mead, 533 U.S. at 228 (quoting Skidmore, 323 U.S. at 140). Consideration of all of these factors leads us to conclude that some deference to Revenue Rule 82-20 is proper.[3]

Aeroquip-Vickers argues that "neither the ITC regime nor the consolidated return regulations contain any ambiguity justifying Rev. Rul. 82-20." Aeroquip-Vickers further contends that Revenue Ruling 82-20 is inconsistent with § 1.1502-3(f) because the express terms of § 1.1502-3(f) do not explicitly refer to "intent"or "timing" requirements. As previously discussed, substantially similar challenges to Revenue Ruling 82-20 were considered and rejected by both the Second and Ninth Circuits in Salomon and Walt Disney. "Uniformity among the circuits is especially important in tax cases to ensure equal and certain administration of the tax system. We would therefore hesitate to reject the view of another circuit." Nickell v. Commissioner, 831 F.2d 1265, 1270 (6th Cir. 1987).

Moreover, the approach favored by CIR and adopted by the Second and Ninth Circuits is entirely reasonable. Example 5 of CRR § 1.1502-3(f) involves a situation where the asset transfer occurs in one year and the spin-off takes place in the following year, while Revenue Ruling 82-20 applies to

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[2] A recent Tax Court Memorandum decision also grants a revenue ruling Skidmore deference. See Tedokon v. Comm'r, 2002 Tax Ct. Memo LEXIS 328, 84 T.C.M. (CCH) 657, T.C. Memo 2002-308 (2002).

[3] As Judge Swift of the Tax Court noted below in dissent, "the weight to be given a revenue ruling is not the issue in this case. Rather, the issue is the validity of the underlying rationale of Rev. Rul. 82-20." Put differently, the amount of deference to be accorded to Revenue Ruling 82-20 ultimately turns upon the validity of its reasoning.

situations where (as in the instant case) the asset transfer is "immediately" followed by the spin-off. Whether the use of different years "merely illustrates the sequence of events," as Aeroquip-Vickers argues, or rather signifies a "meaningful time delay" between the two steps, Salomon, 976 F.2d at 842, is an extremely close question. However, the more persuasive interpretation is that the decision to assign different events to different calender years in Example 5 of CRR § 1.1502-3(f), rather than merely listing the order of events, has greater significance. *See* 2A Singer, Norman J., *Sutherland Statutes and Statutory Construction*, § 46.06 at 192 (2000 ed.) ("every word of a statute must be presumed to have been used for a purpose"). Consequently, we conclude that the underlying rationale of Revenue Ruling 82-20 is valid, "reflects the agency's longstanding interpretation of its own regulations," and thus deserves "substantial judicial deference." Cleveland Indians Baseball Co., 532 US. at 220.

Aeroquip-Vickers also argues that the "step transaction doctrine" is inapplicable in this case, since CIR has stipulated that valid business reasons existed for the intermediate steps taken by LOF. The step-transaction doctrine was not directly addressed in either Salomon or Disney. However, as Judge Swift of the Tax Court observed in his dissenting opinion, both of those decisions "relied heavily on 'economic reality' and the 'substance-over-form' doctrines, which are simply broader labels for, and which encompass, the step transaction doctrine." Trinova Corp. v. Commissioner, 108 T.C. 68, 79 (1997) (Swift, J., dissenting). When analyzing the question of whether the separate steps of a complex transaction should be treated as having independent significance or as related steps in a unified transaction, "courts have enunciated a variety of doctrines, such as step transaction, business purpose, and substance over form. Although the various doctrines overlap and it is not always clear in a particular case which one is most appropriate, their common premise is that the substantive realities of a transaction determine its tax consequences." King Ent. Inc. v. United States, 189 Ct. Cl. 466, 418 F.2d 511, 516 n. 6 (Ct. Cl. 1969); see also Comm'r

v. Court Holding Co., 324 U.S. 331, 334, 89 L. Ed. 981, 65 S. Ct. 707 (1945) ("The incidence of taxation depends upon the substance of a transaction."); Brown v. United States, 782 F.2d 559, 563 (6th Cir. 1986) ("The step transaction doctrine is a judicial device expressing the familiar principle that in applying the income tax laws, the substance rather than the form of the transaction is controlling.") (quotation omitted).

This court has applied the "end result" test in order to determine whether the steps of a transaction should be treated separately or as a single unit. Brown, 782 F.2d at 563-564. "Under that test, purportedly separate transactions will be amalgamated into a single transaction when it appears that they were really component parts of a single transaction *intended from the outset* to be taken for the purpose of reaching the ultimate result." *Id.* at 564 (quotations omitted) (emphasis added).

A recitation of the stipulated facts supports the conclusion that LOF entered the transaction with the intent to move Section 38 property out of the consolidated group. In late 1985 representatives of Pilkington approached LOF concerning the possibility of acquiring its glass business. Negotiations concerning this transaction took place between November 1985 and March 1986. LOF's transfer of its glass business and its Section 38 property to LOF Glass occurred on March 6, 1986. One day later, LOF, Pilkington, and Pilkington Holdings entered into an agreement providing that LOF would transfer all of its interest in LOF Glass to Pilkington Holdings in exchange for Pilkington Holdings' entire interest in LOF. On April 28, 1986, Pilkington exchanged shares of LOF for the shares of LOF Glass. After that date, LOF Glass was no longer part of LOF's affiliated group, nor was it part of LOF's consolidated federal income tax return. From the beginning, an intent on the part of LOF to move Section 38 property out of the consolidated group without paying recapture taxes by first transferring the property to LOF Glass and then distributing LOF Glass's stock to Pilkington is evident.

Aeroquip-Vickers argues that, unlike in Disney and Salomon, in this case CIR "stipulated to the propriety not only of each step but also of the entire reorganization and split-off." Aeroquip-Vickers contends that since "the whole transaction and each step along the way had economic substance," no "tax avoidance motive" can be attributed to LOF.

Admittedly, this case does not involve a situation where "the whole undertaking . . . was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, *and nothing else*." Gregory v. Helvering, 293 U.S. 465, 470, 79 L. Ed. 596, 55 S. Ct. 266 (1935) (emphasis added). Aeroquip-Vickers correctly notes that CIR has stipulated that the requirements of 26 U.S.C. § 368(a)(1)(D) were met in this case. The individual steps of the transaction had a valid business purpose. However, "the law is unclear as to the relationship between the step transaction doctrine and the business purpose requirement. Our survey of the relevant cases suggests that no firm line delineates the boundary between the two." Associated Wholesale Grocers, Inc. v. United States, 927 F.2d 1517, 1526 (10th Cir. 1991). In Associated Wholesale Grocers, the Tenth Circuit held that the existence of a valid business purpose does not preclude application of the step transaction doctrine, explaining that "'[a] legitimate business goal does not grant [a] taxpayer carte blanche to subvert Congressionally mandated tax patterns.'" Id. at 1527 (quoting Kuper v. Commissioner, 533 F.2d 152, 158 (5th Cir. 1976)). The substance over form inquiry thus is not as narrow as Aeroquip-Vickers suggests.

Here, although the individual steps of the transaction had a legitimate business reason, the transaction must be treated as a single unit and judged by its end result. "To ratify a step transaction that exalts form over substance merely because the taxpayer can either (1) articulate some business purpose allegedly motivating the indirect nature of the transaction or (2) point to an economic effect resulting from the series of steps, would frequently defeat the purpose of the substance

over form principle." True v. United States, 190 F.3d 1165, 1177 (10th Cir. 1999). Aeroquip-Vickers has shown only the existence of a non-tax business purpose for engaging in a series of transactional steps "to accomplish a result [it] could have achieved by more direct means." Id. (quoting Associated Wholesale Grocers, 927 F.2d at 1527). Notwithstanding this business purpose, CIR correctly concluded that the intended end result of the transaction was to allow LOF to avoid liability for ITC recapture.

III.

For the foregoing reasons, we reverse the decision of the Tax Court.

CLAY, Circuit Judge, dissenting.

The majority overstates the level of deference revenue rulings receive. The Supreme Court's decision in United States v. Mead, 533 U.S. 218, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001), compels me to respectfully dissent. New circuit precedents, in Omohundro v. United States, 300 F.3d 1065 (9th Cir. 2003) (per curiam), United States Freightways Corp. v. Comm'r, 270 F.3d 1137 (7th Cir. 2001), and American Express Co. v. United States, 262 F.3d 1376 (Fed. Cir. 2001), are cited by the majority to temper the impact of Mead. But as discussed below, these cases do not diminish Mead nearly to the extent that would be necessary to reach the result arrived at by the majority. I also wish to emphasize that assuming, *arguendo*, we wanted to defer to expertise, we would affirm the Tax Court.

This opinion is noteworthy because it involves a three-judge panel of the Court of Appeals reversing (by a two-to-one vote) a "fully reviewed" (effectively "en banc") eleven-to-six decision by the United States Tax Court, which handles only complex tax disputes and consists of seventeen eminent jurists who specialize exclusively in tax law. An overwhelming majority of the Tax Court found Commissioner's Revenue Ruling unpersuasive, although two of three judges of this Court find the Revenue Ruling

compelling--in part because Commissioner drafted the regulation. Commissioner is also a party to this dispute; in fact, the IRS seeks to collect millions of dollars. The Tax Court's experts have no stake in the outcome.

To simplify this controversy: two different kinds of tax guidelines conflict. On its face, a treasury regulation, § 1.1502-3(f), seems to support Taxpayer. An interpretation of that regulation, Rev. Rul. 82-20, seems to support Commissioner. The question is whether the regulation itself or the Revenue Ruling governs the disputed transaction.I.

In footnote three, the majority explains that "the amount of deference to be accorded to Rev. Rul. 82-20 ultimately turns upon the validity of its reasoning." I completely agree. Mysteriously, however, the majority also states that the Tax Court erred "by noting only that revenue rulings 'are not entitled to the deference accorded a statute or a Treasury regulation,' without explicitly acknowledging that some deference to revenue rulings is proper." To the extent the majority implies that a revenue ruling could ever receive more deference than its persuasive value warrants, the majority is incorrect.

As the majority properly notes, the Supreme Court's decision in United States v. Mead, 533 U.S. 218, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001), restricted the scope of *Chevron* deference.[4] Mead involved a tariff ruling by the

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[4] The Supreme Court foreshadowed Mead in Christensen v. Harris County, 529 U.S. 576, 146 L. Ed. 2d 621, 120 S. Ct. 1655 (2000). Christensen declined to grant Chevron deference to an opinion letter signed by the acting administrator of the Wage and Hour Division of the Department of Labor, holding that "interpretations such as those in opinion letters--like interpretations contained in policy statements, agency manuals, and enforcement guidelines--do not warrant Chevron-style deference." Id. at 587. Christensen held that documents issued without the force of law do not receive Chevron deference, see id., but the opinion provided little guidance as to when and to what types of agency statements this exception would apply.

Customs Service that classified Mead's "day planners" as diaries for assessment purposes under the Harmonized Tariff Schedule of the United States, 19 U.S.C. § 1202. 533 U.S. at 224. After reviewing Chevron, the Court stressed that "the fair measure of deference to an agency administering its own statute has been understood to vary with circumstances, and courts have looked to the degree of the agency's care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency's position." Id. at 228 (citation omitted). Chevron applies only if "Congress would expect the agency to be able to speak with the force of law when it addresses ambiguity in the statute or fills a space in the enacted law." Id. at 229. Furthermore, even if the agency has the legislative authority to act with the force of law, "the agency interpretation claiming deference [must be] promulgated in the exercise of that authority." Id. at 227. The Mead Court ultimately found against the Customs Service because "the terms of the congressional delegation give no indication that Congress meant to delegate authority to Customs to issue classification rulings with the force of law." Id. at 232-33.

Mead explained that "a very good indicator of delegation meriting Chevron treatment is express congressional authorizations to engage in the process of rulemaking or adjudication that produces regulations or rulings for which deference is claimed." 533 U.S. at 229. According to Mead, when Congress wants an agency to act with legal force, it wants the agency to guarantee "fairness and deliberation," which the use of a "relatively formal administrative procedure tends to foster." Id. at 230. Mead also states that notice-and-comment procedures are not the only indicator that Congress intended an agency to act with the force of law, because "other statutory circumstances" may sometimes signal the same legislative objective. Id. 229. The Court, however, cited only one case, NationsBank v. Variable Annuity Life Insurance Co., 513 U.S. 251, 130 L. Ed. 2d 740, 115 S. Ct.

810 (1995), in which an agency ruling received Chevron deference without notice-and-comment procedures.[5]

The majority agrees that Chevron does not apply to revenue rulings because such rulings are issued without the force of law.[6] See also Omohundro v. United States, 300

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[5] It is hard to understate Mead's importance. Justice Scalia described the decision as "one of the most significant opinions ever rendered by the Court dealing with the judicial review of administrative action." 533 U.S. at 261 (Scalia, J., dissenting). Mead effectively limits Chevron to situations in which the agency can show "affirmative legislative intent" that it has lawmaking power. Id. at 239 (Scalia, J., dissenting). When Congress intends for the Treasury Department to issue policy statements that have the legal force, Congress clearly so indicates. See, e.g., I.R.C. § 40(f)(3) (authorizing the Secretary to prescribe by regulation the manner in which taxpayers may elect not to have alcohol fuel credits apply); id. at § 414(o) (authorizing the Secretary to prescribe regulations necessary to achieve the purposes of the low income housing credit); id. at § 42(o) (authorizing the Secretary to prescribe regulations to prevent avoidance of employee benefit provisions). A Treasury Regulation expressly states that revenue rulings "do not have the force and effect of Treasury Department regulations" (which do have legal force). Rev. Proc. 89-14, 1989-1 C.B. 814.

[6] However, the majority tries to minimize this. After writing that, "in light of the Supreme Court's decisions in Christensen and Mead, we conclude that Revenue Ruling 82-20 should not be accorded Chevron deference," the majority notes that "revenue rulings do, however, constitute 'precedents [to be used] in the disposition of other cases.' Rev. Proc. 89-14, 1989-1 C.B. 815. Revenue rulings also serve as 'official interpretations' by the IRS of the tax laws. Treas. Reg. § 601.201(a)(6)." (alterations in majority op.). Yet neither the fact that revenue rulings are "official" or serve as precedent for the IRS to use in other cases gives revenue rulings legal force. See Rev. Proc. 89-14, 1989-1 C.B. 814. Under Mead, the absence of legal force is the primary indicia of a regulation warranting only Skidmore deference, see Mead, 533 U.S. at 232-33, and neither the "officiality" of revenue rulings nor the Treasury Department's intent that the IRS use revenue rulings to guide subsequent decisions makes the revenue ruling itself likely to better withstand Skidmore scrutiny because neither factor makes the revenue ruling necessarily more thoroughly considered, consistent, valid, or otherwise persuasively reasoned. See Skidmore v. Swift & Co., 323 U.S. 134, 140, 89 L. Ed. 124, 65 S. Ct. 161 (1940).

F.3d at 1068 ("Mead involved a Customs Service tariff ruling, which is closely akin to an IRS revenue ruling. Given that the two types of agency rulings are analogous, we are required to apply Mead's standard of review to an IRS revenue ruling."); U.S. Freightways Corp., 270 F.3d at 1141 (declining to give Chevron deference to IRS policy statements made without notice-and-comment formalities); Am. Express Co. v. United States, 262 F.3d at 1382-83 (stating that IRS decisions not adopted in regulations after notice and comment are probably not entitled to Chevron deference). The Mead Court noted that agency statements ineligible for Chevron deference may still receive Skidmore deference. Mead, 533 U.S. at 234-35 ("Chevron left Skidmore intact and applicable where statutory circumstances indicate no intent to delegate general authority to make rules with force of law, or where such authority was not invoked.")

In Skidmore v. Swift & Co., 323 U.S. 134, 89 L. Ed. 124, 65 S. Ct. 161 (1944), the Court gave an agency pronouncement only the weight it deserved in light of "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade." Id. at 140.

When the majority claims the Tax Court erred by failing to acknowledge that "*some* deference to revenue rulings is proper" (emphasis added), the majority overstates Skidmore "deference." Skidmore "deference" does not always involve "deferring" because the level of respect afforded the agency pronouncement depends on its "power to persuade." Skidmore, 323 U.S. at 140. An agency pronouncement with no persuasive power receives no deference. Therefore, because the Tax Court majority found the Treasury Department's justification for its revenue ruling unpersuasive, the Tax Court did not err by failing to acknowledge that "some deference to revenue rulings is proper." Likewise, to the extent this Court finds the Treasury Department's rationale unpersuasive, we have no obligation to defer.

Exactly as the majority explains, "the amount of deference to be accorded to Revenue Ruling 82-20 ultimately turns upon the validity of its reasoning."

The majority cites a string of four cases in support of its statement that even after Mead "some deference to revenue rulings is proper." Yet none of these cases push Skidmore "deference" to the level that the majority would have in the present case. The first case cited, Omohundro, 300 F.3d 1065, grants Skidmore "deference." But as explained, Skidmore "deference" relies on the "power to persuade." Omohundro granted "deference" only after ruling, "First, the IRS's reasoning is valid." Id. at 1068. The "deference" accorded was to persuasive reasoning, not merely to IRS interpretive authority. The majority in the present dispute accords deference based upon the Revenue Ruling itself, apart from its persuasive power.

The second case cited, Del Commercial Props., Inc. v. Comm'r, 346 U.S. App. D.C. 149, 251 F.3d 210, 214 (D.C. Cir. 2001), was released ten days before Mead. Given that the majority acknowledges the relevance of Mead, it is not clear why this case is cited.

The third case cited by the majority, U.S. Freightways Corp. v. Comm'r, 270 F.3d at 1139, states:

> Although we acknowledge that even after United States v. Mead Corp., 533 U.S. 218, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001), we owe some deference to the Commissioner's interpretation of his own regulations, we conclude here that the lack of any sound basis behind the Commissioner's interpretation, coupled with a lack of consistency on the Commissioner's own part, compels us to rule in favor of Freightways.

This statement highlights again the importance of Mead. While U.S. Freightways professes to accord some "deference," it is not at all clear that the term is being used to signify anything substantially beyond than the "power to

persuade," under Skidmore. After all, as stated in the quoted passage above, U.S. Freightways rejected the Commissioner's ruling, which severely calls into question the amount of true deference that was actually given by the Seventh Circuit.

The last case cited by the majority is Am. Express Co., 262 F.3d 1376. This case, unlike U.S. Freightways, held in favor of the Commissioner. However, American Express is readily distinguishable from the present case. In American Express, the court ruled that the interpretation was not at all in conflict with the applicable regulation, since on its face the regulation simply did not address the issue at hand. Id. at 1381 ("There is nothing on the face of IRS Rev. Proc. 71-21 that defines the term 'services,' . . . ."). By contrast, in the present case, the regulation on its face addressed the issue with sufficient clarity to warrant a ruling from the Tax Court, in favor of Taxpayer. Thus, even though American Express professed to accord "deference" to the IRS interpretation, the context in that case was such that the amount of actual deference accorded was not nearly as great as that accorded by the majority in the present case.

While the language contained in Omohundro, U.S. Freightways, and American Express does indicate that even after Mead some "deference" is due to revenue rulings, it is not at all clear that this deference is anything more than Skidmore "deference," which simply mandates that the reviewing court must consider agency interpretations, examining them for their "power to persuade."

The following sections explain why the government's reasoning is invalid.

II.

Unlike the majority, I see no reason to rely on two equally antiquated decisions from other circuits that deal with

ostensibly similar tax controversies.[7] Both Walt Disney, Inc. v. Comm'r, 4 F.3d 735 (9th Cir. 1993), and Salomon, Inc. v. United States, 976 F.2d 837 (2d Cir. 1992), accepted Petititoner's interpretation in Rev. Rul. 82-20. These cases are distinguishable and outdated.

In both Disney and Salmon, the taxpayers sought rulings from the IRS as to whether they would qualify for tax-free "D" reorganizations. Disney, 4 F.3d at 737; Salomon, 976 F.2d at 839. Also in both cases, the taxpayers represented to the IRS that they would recapture ITCs associated with property transferred to newly formed subsidiaries. The IRS then issued private letter rulings stating that the transactions would qualify as tax-free "D" reorganizations. See Priv. Ltr. Rul. 8215003 (Oct. 22, 1981) (Disney ruling); Priv. Ltr. Rul. 8132115 (May 18, 1981) (Salomon ruling). Each taxpayer then reorganized its business, but did not recapture the ITCs. Disney, 4 F.3d at 736; Salomon, 976 F.2d at 838. In the ensuing litigation, Commissioner did not challenge the effectiveness of the reorganizations, see Disney, 4 F.3d at 738; Salomon, 976 F.2d at 839, but Commissioner never expressly stipulated that the transactions met the requirements of § § 355 and 368(a)(1)(D). In contrast, Commissioner made that stipulation in this case, which means Commissioner concedes that the split-off was "not used principally as a device for the distribution of the earnings and profits" of LOF or LOF Glass. *See* I.R.C. § 355(a)(1)(B).[8]

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[7] The majority properly emphasizes that "'uniformity among the circuits is especially important in tax cases to ensure equal and certain administration of the tax system.'" (quoting Nickell v. Commissioner, 831 F.2d 1265, 1270 (6th Cir. 1987)). This principle does not limit our obligation to react to new Supreme Court decisions. As discussed further below, the majority wrongly relies on Chevron-era tax precedents. We cannot ignore Mead in the name of consistency.

[8] As the majority notes, the Salomon court depended heavily on its conclusion that in substance, if not in form, the direct and the circuitous transaction are the same. Each achieves a rapid transfer of section 38 property outside the group. To distinguish between them would deny

Even without this distinction, neither Disney nor Salomon should influence this Court. Both Disney and Salomon explicitly stated that IRS revenue rulings deserve "great deference." Disney, 4 F.3d at 740-41; Salomon, 976 F.2d at 841. We cannot know what conclusion the Salomon or Disney courts would have reached had they not afforded the Commissioner "great deference" revenue rulings unquestionably no longer receive. See Omohundro v. United States, 300 F.3d at 1068; U.S. Freightways Corp., 270 F.3d at 1141; Am. Express Co., 262 F.3d at 1382-83. This tremendous difference makes Disney and Salomon inapplicable in contemporary tax litigation.

III.

The next step is to consider whether the Commissioner has offered a persuasive position.

A.

The consolidated return provisions in the tax code allow multiple corporations (including a parent and subsidiaries) to file a single consolidated tax return. I.R.C. § § 1501, 1504(a)(1). The majority notes this, but fails to recognize how the single taxpayer theory implicates the present controversy.

To file a consolidated return, each subsidiary must be linked, directly or indirectly, to the common parent by an ownership chain of both 80% of the voting power of the subsidiary and 80% of the value of the subsidiary's stock. I.R.C. § 1504(a)(2). Once a group of corporations elects to

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economic reality. Moreover, such a holding would allow the common parent of a consolidated group . . . to move section 38 property outside the group without paying recapture taxes simply by first transferring the property to a member subsidiary and then distributing the subsidiary's stock to the third-party. 976 F.2d at 842. Disney then quotes this text. *See* 4 F.3d at 739. We cannot conclude that Respondent intended "to move section 38 property outside the group without paying recapture taxes," see Salomon, 976 F.2d at 842, when Commissioner concedes that the split-off was "not used principally as a device for the distribution of the earnings and profits." See I.R.C. § 355(a)(1)(B).

file a consolidated return, the corporations must remain in the group unless they cease to qualify as group members or the Secretary consents to deconsolidation. I.R.C. § § 1501, 1504; Treas. Reg. 1.1502-75. Congress and the Treasury Department realized that "in substance, there was little distinction between a corporation that chose to conduct its business by means of divisions and another corporation that preferred to operate its various businesses through subsidiaries." Crestol, et al., The Consolidated Tax Return P 1.01 at 1-2 (5th ed. 2000). Therefore, consolidated returns allow parents and subsidiaries to be treated as though they were a "single taxpayer." Commissioner concedes that the economic approach underlying the consolidated return regime is the "single taxpayer theory." (Comm'r Br. at 14-16.) As noted, the majority offers no response to this argument.

B.

Congress delegated authority to the Treasury Department to promulgate regulations governing the distribution of tax credits among the members of a consolidated group. Accordingly, the Secretary of the Treasury instituted § 1.1502-3, which covers the handling of "consolidated tax credits," including the disposition of Section 38 property. See Treas. Reg. § 1.1502-3(f). Under section 1.1502-3(f)(2)(i):

> a transfer of Section 38 property from one member of the group to another member of such group during a consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1). If such Section 38 property is disposed of, or otherwise ceases to be Section 38 property or becomes public utility property with respect to the *transferee*, before the close of the estimated useful life which was taken into account in computing qualified investment, then section 47(a)(1) or (2) shall apply to the *transferee* with respect to such property (determined by taking into account the period of use, qualified investment, other dispositions, etc., of the

> transferor). Any increase in tax due to the application of section 47(a)(1) or (2) shall be added to the tax liability of such *transferee* (or the tax liability of a group, if the transferee joins in the filing of a consolidated return).

(emphasis added). Thus, the regulation tests the transferee to determine whether it must recapture ITCs and whether the transferee may report the recapture on its separate return (if it has left the consolidated group) or the consolidated group return (if the transferee remains a member of the group).[9] No other consolidated return regulation addresses ITC recapture and no other regulation explicitly requires ITC recapture when a transferee of Section 38 property is split-off from the affiliated group in a valid "D" reorganization. The majority offers no response to this argument.

C.

Once § 1.1502-3(f)(2)(i) imposes transferee liability for ITC recapture on consolidated group members, § 1.1502-3(f)(3) provides five illustrations of how § 1.1502-3(f)(2)(i) will apply:

> Example (1). P, S, and T file a consolidated return for calendar year 1967. In such year S places in service Section 38 property having an estimated useful life of more than 8 years. In 1968, P, S, and T file a consolidated return and in such year S sells such property to T. Such sale will not cause section 47(a)(1) to apply.

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[9] This is different from the ITC provisions in the I.R.C. § 47(a)(1) and (2). In § 47, while a transfer between non-consolidated group members may constitute a "mere change in form that does not trigger recapture," it is the transferor that the IRS holds liable for the recapture if the transferee disposes of the property or the transferor disposes of its interest in the transferee. The transferee has no liability at all. I.R.C. § 47(b).

Example (2). Assume the same facts as in example (1), except that P, S, and T filed separate returns for 1967. The sale from S to T will not cause section 47(a)(1) to apply.

Example (3). Assume the same facts as in example (1), except that P, S, and T continue to file consolidated returns through 1971 and in such year T disposes of the property to individual A. Section 47(a)(1) will apply to the group and any increase in tax shall be added to the tax liability of the group. For the purposes of determining the actual period of use by T, such period shall include S's period of use.

Example (4). Assume the same facts as in example (3), except that T files a separate return in 1971. Again, the actual periods of use by S and T will be combined in applying section 47. If the disposition results in an increase in tax under section 47(a)(1), such additional tax shall be added to the separate tax liability of T.

Example (5). Assume the same facts as in example (1), except that in 1969, P sells all the stock of T to a third party. Such sale will not cause section 47(a)(1) to apply.

When closely scrutinized, these examples vindicate Taxpayer's position.

In example one, P, S, and T are members of a consolidated group at all times. There is no § 47 disposition of the Section 38 property when S obtains it and sells it to T, because T has simply assumed S's role.

In example two, S acquires the property from P before the corporations become members of a consolidated group. S then transfers the property to T after the corporations form a consolidated group. P still did not engage in a § 47 transfer

because the entire transaction occurred within a consolidated group.

In example three, the corporations acquire and transfer the Section 38 property while belonging to a consolidated group, but T then transfers the Section 38 property to some unrelated party. This triggers a § 47 ITC recapture for which the consolidated group is responsible.[10]

In example four, when T transfers the Section 38 property to an unrelated third party, P, S, and T are no longer members of a consolidated group. Thus, T files a separate return. T's transfer outside the group triggers the ITC recapture and that "additional tax shall be added to the separate tax liability of T." Treas. Reg. § 1.1502-3(Ex. 4). The liability is not imposed on S, the transferor of the Section 38 property, or P, the other group member. Transferee liability is imposed on T. This reflects the policy embedded in § 47 and the ITC provisions that the responsible entity (now T) must continue to use Section 38 property its trade or business for the appropriate period.

In example five (like example one), the Section 38 property was acquired by S and transferred to T while all parties remained members of a consolidated group. When P sells T's stock to a third party, no recapture occurs. The rule of transferee liability dictates that there is no ITC recapture because T remains liable for ITC obligations as the transferree of Section 38 property. If T disposes of the property, ceases using it in its trade or business, or joins a new consolidated

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[10] Commissioner argues that this result occurs because the regulations (and examples) assume that the consolidated group members initially intended for the property to remain within the group. This speculation ignores § 1.1502-3(f)(2), which imposes liability based on whether or not an intra-group transfer took place, not whether or not the parties intended the Section 38 assets to remain in the group after the transfer. Notably, the regulations contemplate that T may leave the group and file its own return or a return with a new consolidated group. See Treas. Reg. § 1.1502-3(f)(2)(i).

group, T will be liable.[11] The original transferor has no post-transfer recapture liability.

Example five reflects precisely what happened in this case. A parent (LOF) transferred Section 38 assets to a subsidiary (LOF Glass) that was a member of the parent's consolidated group. The parent then transferred its stock in the subsidiary to a third party outside the consolidated group (Pilkington).[12] According to example five, any liability for recapture lies with the transferee, not with the original parent/transferor.

D.

In Rev. Rul. 82-20, 1982-1 C.B. 6, the IRS considered the application of the ITC recapture provisions of the IRC and the consolidated return regulations. Specifically, the IRS applied § 1.1502-3(f) to a corporate reorganization which, as in this case, qualified under § § 355(a)(1) and 368(a)(1)(D) for nonrecognition treatment. The ruling involved a transfer of assets, including Section 38 property, by a parent corporation to its wholly-owned subsidiary, followed by a distribution of the subsidiary's stock to one of the parent corporation's shareholders. Since the parent and the subsidiary filed a consolidated tax return, the situation addressed in the Revenue Ruling is very similar to that presently before this Court.

The ruling initially noted that under Treas. Reg. § 1.47-3(f)(5)(ii) a recapture determination is required when the transferor of the Section 38 property does not retain a substantial interest in the subsidiary. This is in tension with § 1.1502-3(f)(2)(i), which does not treat the transfer from one

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[11] If T joins a new consolidated group, then T and the other members of the new consolidated group would then be liable. See Treas. Reg. § 1.1502-3(f)(2).

[12] As described above, this transfer occurred in exchange for the third party's (Pilkington's) stock in the parent (LOF).

member of a consolidated group to another as a § 47 disposition. To reconcile these provisions, the Commissioner assumed that the consolidated return regulation, § 1.1502-3(f)(2)(i), was "premised on the assumption that the property [would] remain[] within the consolidated group. When there is no intention at the time of the transfer to keep the property within the consolidated group, the transaction should be viewed as whole and not as separate transactions." Rev. Rul. 82-20.

The rationale, according to the Commissioner, is that a parent corporation's transfer of Section 38 property to its wholly-owned subsidiary is not treated as a disposition so long as the parent corporation substantially owns the subsidiary. I.R.C. § 47(b). When such a transfer is followed by a split-off of the subsidiary's stock, however, recapture is imposed immediately because the transferor no longer retains a "substantial interest" in the transferee. If the government has correctly interpreted § 1.1502-3(f)(2)(i), then Taxpayer must recapture the ITCs. The majority offers no response to this argument.

E.

Rev. Rul. 82-20 is inconsistent with § 1.1502-3(f)(2)(i) because the treasury regulation focuses on making the transferee responsible for the Section 38 property, whereas the Revenue Ruling looks to the "intent" of the parties in the consolidated group. Depending on whether the parties in the consolidated group intended to transfer the Section 38 property to a third party ultimately, either the transferor or the transferee may have to recapture the ITCs.

First, if intent were the decisive factor under the regulation, the regulation would make that clear. Commissioner argues that the regulation does make that clear, because in crucial example five, the parent, subsidiary, and transferee file consolidated returns in 1967 and 1968, and the subsidiary transfers its Section 38 property in 1968, but the parent does not sell the transferee's stock until 1969. §

1.1502-3(f)(3) (Ex. 5). Commissioner concludes that the parent does not recapture the ITCs in this example only because the parent waited a year before selling the transferee's stock.[13] Since the hypothetical parent waited a year, the consolidated group must not have "intended" to move the assets outside of the group when it transferred them within-group to its subsidiary.

This extraordinarily strained hypothesis is hard to accept primarily because the relevant regulations never mention intent. One cannot reasonably believe that the Treasury Department meant an intent test but, rather than saying so expressly, it said so through the circuitous route Commissioner defends. A parent company could certainly wait a year before transferring assets outside the consolidated group, yet have intended to make the transfer from the outset. Most likely, example five has the relevant events occurring in different years simply to make the hypothetical as simple and clear as possible with respect to the order in which the transactions take place. That certainly seems a more plausible explanation than to assume the reference to a different year somehow implies an intent standard. It also seems reasonable that the Treasury Department merely wanted example five to illustrate the clear language in § 1.1502-3(f)(2), which places obligations on the transferee without discussing the transferor's intent.[14]

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[13] This example stand in contrast to this case, in which the parent waited only a weekend to make the transfer.

[14] Treas. Reg. § 1.1502-3(f)(2)(i) states:

> a transfer of Section 38 property from one member of the group to another member of such group during a consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1). If such Section 38 property is disposed of, or otherwise ceases to be Section 38 property or becomes public utility property with respect to the *transferee*, before the close of the estimated useful life which was taken into account in computing qualified investment, then section 47(a)(1) or (2) shall apply to the *transferee* with

Second, the interpretation in Rev. Rul. 82-20 fails to respect the single-taxpayer theory that underlies the consolidated return regulations. As already noted, according to I.R.C. § 47(a) (1) and (2), if a transfer between *non*-consolidated group members triggers recapture, the *transferor* is liable for the recapture while the transferee has no liability. I.R.C. § 47(b); Treas. Reg. § 1.47-3(f)(5). The single

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> respect to such property (determined by taking into account the period of use, qualified investment, other dispositions, etc., of the transferor). Any increase in tax due to the application of section 47(a)(1) or (2) shall be added to the tax liability of such *transferee* (or the tax liability of a group, if the transferee joins in the filing of a consolidated return).

(emphasis added).

The majority claims that:

> the more persuasive interpretation is that the decision to assign different events to different calendar years in Example 5 of CRR § 1.1502-3(f), rather than merely listing the order of events, has greater significance. See 2A Singer, Norman J., Sutherland Statutes and Statutory Construction, § 46.06 at 192 (2000 ed.) ("every word of a statute must be presumed to have been used for a purpose").

The majority wants to infer an intent test because example five lists separate calendar years, instead of simply the order of events. This argument is silly. Had the Commissioner listed the order of events, rather than calendar years, it would not make an intent test a less plausible inference--a taxpayer *intending* to transfer § 47 assets out of the consolidated group would could still undertake the same series of transactions in the same allegedly nefarious sequence. The reference to "calendar years" as opposed to "the order of events" indicates nothing about whether the Commissioner meant to incorporate an intent test.

The Commissioner's choice of language, however, tells us much more. If the Commissioner wanted an intent test, he could have used the word "intent" in his example. *Sutherland* also supports my interpretation. *See, e.g.*, 2A Norman J. Singer, Sutherland Statutes and Statutory Construction § 46.06 at 135 (2000 ed.) ("What a legislature says in the text of a statute is considered the best evidence of the legislative intent or will."); Singer, *supra*, § 47:23 at 304-06 (explaining that the doctrine of *expressio unius est exclusio alterius* indicates "an inference that all omissions should be understood as exclusions").

taxpayer theory, however, involves ignoring transactions between members of a consolidated group. By attempting to impose recapture liability on the transferor, Commissioner would create situations--like this one--where liability would remain with the group even after the subsidiary holding the assets has left. This conflicts with the single-entity approach by treating a now-separate corporation as though it still belonged to the consolidated group.[15] It is significant, therefore, that the Supreme Court attempts to interpret the consolidated return regulations in a manner consistent with the single-entity theory. See United Dominion Industrs. v. United States, 532 U.S. 822, 150 L. Ed. 2d 45, 121 S. Ct. 1934 (2001) (holding that the single-entity approach is the proper method for calculating product liability losses among a consolidated group).

Due to the single-taxpayer theory embodied in the consolidated return regulations and the resulting transferee liability imposed on LOF Glass for the ITC recapture, LOF's transfer of the Section 38 property to LOF Glass did not trigger § 47; there was no disposition of Section 38 property, and thus no ITC recapture. See Treas. Reg. § 1.1502-3(f)(2)(i). Commissioner argues that even if this is the correct interpretation of § 1.1502-3(f)(2)(i), the initial transaction became relevant for § 47 purposes when LOF Glass left the LOF-affiliated group because the parent (LOF) no longer retained interest in the Section 38 property.

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[15] Commissioner's position is also inconsistent with the notion that the entity with the ability to keep the Section 38 property in the appropriate trade or business use should be the same entity that faces recapture if it fails to do so. It may be more efficient to have the taxpaying party be the one that holds the assets rather than force the transferor to attempt to guarantee their future use *ex ante* by contract, since the property-holder (transferee) can more easily adapt to changes in its economic circumstances over the relevant life of the Section 38 material. Notably, this case is not about whether a tax gets paid, but who will pay it--the transferee or the transferor. Thus, siding with Taxpayer will not necessarily encourage tax avoidance.

In April of 1986, LOF Glass split-off from the LOF affiliated group in the "D" reorganization with the exchange of LOF Glass shares for Pilkington's interest in LOF. This occurred immediately after LOF made LOF Glass an independent subsidiary, but the parties stipulated that LOF Glass continued to use the Section 38 property in the glass business both before and after LOF Glass left the consolidated group. When LOF Glass left the group, it did so subject to the transferee obligation for the ITC recapture that arose when it received the Section 38 property along with the LOF Glass Division business initially. See Treas. Reg. § 1.1502-3(f)(2)(i).

Although Commissioner argues, in accordance with Rev. Rul. 82-20, that these intra-group transfers and the "D" reorganization evince an intent to *avoid* ITC recapture by disposing of the property outside of the group the worst the transactions show is nothing more than a shift in ITC recapture liability.[16] By transferring the LOF Glass Division and the Section 38 property within the consolidated group, the parties imposed liability for the ITC recapture on LOF Glass. When Pilkington acquired LOF Glass--albeit one day later--LOF Glass brought with it the same ITC recapture obligation. If LOF Glass became a member of a Pilkington consolidated group, then that consolidated group would be subject to ITC recapture as well. See Treas. Reg. § 1.1502-3(f)(2)(i). Under the consolidated return regulations, the ITC recapture obligations remained, although now assigned to a different party.

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[16] And it is not necessarily an intentional shift, since Commissioner stipulated that the reorganization was "not used principally as a device for the distribution of the earnings and profits of LOF or LOF Glass." (See J.A. at 57.) The Commissioner's stipulation is discussed more thoroughly in conjunction with the step-transaction issue below.

IV.

Commissioner also argues that the interpretation of § 1.1502-3(f)(2)(i) contained in Rev. Rul. 82-20 is consistent with the "step-transaction doctrine." Commissioner notes that the "incidence of taxation depends upon the substance of a transaction," rather than its form. Comm'r v. Court Holding Co., 324 U.S. 331, 334, 89 L. Ed. 981, 65 S. Ct. 707 (1945); see also Estate of Kluener v. Commissioner, 154 F.3d 630, 634 (6th Cir. 1998). "The step transaction doctrine is a judicial device expressing the familiar principle that in applying the income tax laws, the substance rather than the form of the transaction is controlling." Brown v. United States, 782 F.2d 559, 563 (6th Cir. 1986) (internal quotations omitted). Under this doctrine, "interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction." Comm'r v. Clark, 489 U.S. 726, 738, 103 L. Ed. 2d 753, 109 S. Ct. 1455 (1989). Although various courts have applied different tests to determine whether the step-transaction doctrine applies in a particular case, this Court uses the "end result" test. Brown, 782 F.2d at 564. Pursuant to the "end result" test, "purportedly separate transactions will be amalgamated into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result." Id. (internal quotation marks omitted).

The appeal of step-transaction analysis rapidly dissipates when one remembers that Commissioner stipulated that the transaction appropriately received "D" reorganization treatment, which means Commissioner stipulated, *inter alia*, that the split-off transaction was "not used principally as a device for the distribution of the earnings and profits" of LOF or LOF Glass. See I.R.C. § 355(a)(1)(B). The Commissioner thus conceded that LOF and LOF Glass were engaged in the "active conduct of a trade or business" for at least five years prior to the transaction and for five years after Pilkington

became the owner of LOF Glass. See I.R.C. § 355(a) and (b). If the transfers from LOF Glass Division to LOF Glass and ultimately to Pilkington had economic viability (and thus were not merely tax avoidance transactions), then the step-transaction doctrine cannot apply. *See* Rev. Rul. 79-250, 1979-2 C.B. 156, 157 (explaining that where each step in a corporate reorganization has an independent legal and economic significance, the step-transaction doctrine does not apply).

The majority cites no authority for the proposition that the IRS can accept an entire transaction as justified by a legitimate business purpose to determine whether "D" reorganization treatment will apply, but *not* accept a part of that same transaction as motivated by a legitimate business purpose exclusively to determine ITC recapture--particularly given that the "substance over form" principle requires courts to view transactions "as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant."[17] Court Holding, 324 U.S. at 334.

The majority further concedes, as it must, that this case does not involve a situation where "'the whole undertaking . . . was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, *and nothing*

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[17] One sentence drafted by the majority deserves particular attention. The majority claims, without citation, that "here, although the individual steps of the transaction had a legitimate business reason, the transaction must be treated as a single unit and judged by its end result." I have no idea how a party could possibly intend several steps to achieve various legitimate business purposes but simultaneously intend the *series* of steps to accomplish an illegitimate tax-avoidance objective. As a matter of logic, if an agent undertakes a series of related acts, and if each step is viewed as part of a process intended to achieve an legitimate goal, it is impossible to view all steps as intending to serve illegitimate ends. Somewhere along the line, the agent *must* have intended at least one of the steps to accomplish something improper (in this case, without a legitimate business purpose). Commissioner concedes Respondent acted with a business purpose at every stage.

else.' Gregory v. Helvering, 293 U.S. 465, 470, 79 L. Ed. 596, 55 S. Ct. 266 (1935) (emphasis added)." By emphasizing "and nothing else," the majority implies that, despite the government's stipulation, both a legitimate business purpose and an improper tax avoidance objective motivated the disputed transaction. The majority then cites a Tenth Circuit case, Associated Wholesale Grocers, Inc. v. United States, 927 F.2d 1517, 1526 (10th Cir. 1991), for the general proposition that a taxpayer may not dodge provisions of the tax code merely because the taxpayer can articulate some business purpose for its activity. In the present dispute, however, Taxpayer offers this Court much more than a general assurance that it had a business purpose for its transaction.[18]

Again, the Commissioner stipulated that the transaction properly received "D" reorganization treatment, which means Commissioner stipulated, *inter alia*, that the split-off transaction was "not used *principally* as a device for the distribution of the earnings and profits" of LOF or LOF Glass. See I.R.C. § 355(a)(1)(B) (emphasis added). The phrase "a device for the distribution of . . . earnings and profits" means simply "a device for the distribution of . . . earnings and profits [so as to avoid taxes]." Id. Put differently, the Commissioner conceded that the split-off was not *principally* a tax avoidance mechanism. The majority's Tenth Circuit step-transaction case does not involve any stipulation by Commissioner--let alone a concession that the taxpayer's transaction did not principally serve a tax-avoidance purpose.

Moreover, in Rev. Rul. 79-250, 1979-2 C.B. 156, the Commissioner conceded that in § 368 situations like this one, the step-transaction doctrine would not apply. According to

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[18] In fact, the Associated Grocers court "shared the government's skepticism as to the alleged significance of taxpayer's claimed business purpose." 927 F.2d at 1527. Associated Grocers also involved a completely different statutory provision--a liquidation under I.R.C. § 332 rather than a § 368 restructuring. *Id.* at 1519.

the Commissioner, "*the substance of each of a series of steps will be recognized and the step transaction doctrine will not apply, if each such step demonstrates independent economic significance, is not subject to attack as a sham, and was undertaken for valid business purposes and not mere avoidance of taxes.*" (emphasis added). This seems to resolve the matter, and the majority has no rational reason to defer to Rev. Rul. 82-20 at the expense of Rev. Rul. 79-250.

V.

More than two decades ago, this Court correctly observed that the Treasury Department's consolidated return regulations should receive greater deference than interpretations of those regulations. See Wolter Constr. v. Comm'r, 634 F.2d 1029, 1034-35 (6th Cir. 1980). This principle unquestionably applies here. It seems either very difficult or impossible for an interpretive statement to survive Skidmore review when that statement conflicts with the text it purports to interpret. Commissioner's Revenue Ruling is not persuasive because it contradicts the text and examples in § 1.1502-3(f).

For all the aforementioned reasons, I respectfully dissent.

APPENDIX B

No. 01-2741

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

AEROQUIP-VICKERS, INC. and SUBSIDIARIES,
f/k/a Trinova Corp. and Subsidiaries,
Petitioner-Appellee,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

Filed: January 21, 2004

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BEFORE: CLAY and GIBBONS, Circuit Judges; and DUGGAN, District Judge.

Order

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied. Judge Clay would grant rehearing for the reasons stated in his dissent.

APPENDIX C

No. 2931-94

UNITED STATES TAX COURT

TRINOVA CORPORATION AND SUBSIDIARIES,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

FILED: February 27, 1997

Frederick E. Henry, Jeffrey M. O'Donnell, and Julie C. H. Walsh, for petitioners.

Nancy B. Herbert and Reid M. Huey, for respondent.

OPINION

TANNENWALD, Judge:

Respondent determined the following deficiencies in petitioner's Federal income taxes and additions to tax:

		Addition To Tax
Year	Deficiency	Sec. 6661 (a)
1985	$ 117,988	--
1986	11,630,928	$ 1,429,687
1987	4,924,255	--
1988	834,875	--

After concessions, the issue for decision is whether petitioner is liable for recapture in 1986 of investment tax credits (ITC) claimed on certain section 38[1] assets that were transferred to a wholly owned subsidiary, the stock of which was then transferred out of the consolidated group in a tax-free transaction. If this issue is resolved in favor of respondent, then the issue of the addition to tax under section 6661(a), which relates only to the recapture issue, will have to be decided.[2]

Background

This case was submitted fully stipulated under Rule 122. The stipulation of facts and the accompanying exhibits are incorporated herein by this reference and found accordingly.

Petitioner, an accrual basis taxpayer, had its principal offices in Maumee, Ohio, at the time it filed its petition herein. Petitioner changed its name to Trinova from the Libbey-Owens-Ford Company (LOF) on July 31, 1986. Petitioner timely filed a consolidated Federal income tax return with certain of its subsidiaries for the years at issue with the Internal Revenue Service Center, Cincinnati, Ohio, or the Internal Revenue Service office in Toledo, Ohio. Petitioner was engaged in the fluid power and plastics businesses, and in the manufacture of glass. The glass business was referred to as the "LOF Glass Division".

One of LOF's largest shareholders was Pilkington Brothers (Pilkington), an English company, which owned 29 percent of petitioner's common stock through its wholly owned U.S. subsidiary, Pilkington Holdings, Inc. (Pilkington Holdings). Two of petitioner's fourteen directors were

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the taxable years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] An additional issue, relating to the allocation of deductions between subpart F income and non-subpart F income, will be decided later by a separate opinion.

associated with Pilkington. In late 1985, Pilkington approached LOF and began negotiations concerning the possibility of acquiring the glass business.

Earlier that year, on July 25, 1985, the board of directors of LOF approved the transfer of the glass business to a wholly owned subsidiary for valid business reasons. On February 19, 1986, LOF Glass, Inc. was incorporated as a wholly owned subsidiary of LOF. On March 6, 1986, a "Transfer and Assumption Agreement", amended on April 25, 1986, transferred to LOF Glass, Inc., all assets associated with the LOF Glass Division, including inventories and receivables, effective retroactively to February 19, 1986. These assets also included section 38 assets upon which LOF had previously claimed ITCs. Petitioner took no formal action contemplating the liquidation of LOF Glass, Inc., in the event that the acquisition by Pilkington did not take place.

On March 7, 1986, LOF, Pilkington, and Pilkington Holdings entered into an agreement, amended on April 28, 1986, whereby LOF would transfer all of its shares of LOF Glass, Inc., to Pilkington Holdings in exchange for all of the shares of petitioner held by Pilkington Holdings. On April 28, 1986, Pilkington Holdings exchanged 4,064,550 shares of LOF for the shares of LOF Glass, Inc. LOF Glass, Inc., continued to operate the glass business as a subsidiary of Pilkington Holdings and used the section 38 assets in its trade or business.

The parties have stipulated that petitioner recognized no gain or loss upon the transaction whereby its glass business was transferred to LOF Glass, Inc., pursuant to the provisions of section 351 or sections 354, 355, and 368 (a) (1) (D) (except as required by such sections or section 357 (c)), and that pursuant to section 355 neither petitioner nor Pilkington Holdings recognized any gain or loss upon the exchange of LOF Glass, Inc., shares for the LOF shares.

Before February 19, 1986, income, deductions, and credits with respect to the LOF Glass Division were included

in petitioner's return. From February 19, 1986, through April 28, 1986, deductions and credits with respect to LOF Glass, Inc. (the subsidiary), were included as part of petitioner's consolidated return. After April 28, 1986, LOF Glass, Inc., was no longer part of petitioner, petitioner's affiliated group, or petitioner's consolidated Federal income tax return.

On its 1986 consolidated return, petitioner did not include any amount of ITC recapture with respect to the LOF Glass, Inc., section 38 assets. Respondent determined that a $ 5,718,749 ITC recapture arose from the April 1986 transaction. Petitioner does not dispute the amount of the ITC recapture, should the Court hold petitioner liable for it.

Discussion

The investment tax credit provisions, now repealed but in effect in respect of the taxable year 1986, provided for a tax credit to taxpayers purchasing certain types of property for use in their businesses. Whether petitioner is required to recapture its investment tax credit turns upon the impact of a revenue ruling on what other otherwise appears to be unqualified language of a consolidated return regulation. The issue is not new to this Court whose position has been rejected by two Courts of Appeals. By way of background to our resolution of this judicial conflict, we first turn to a description of the provisions in respect of the investment tax credit pertinent to our analysis.

Section 47 (a) (1)[3] provided for recapture of the investment tax credit:

> If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38 * * *

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[3] Sec. 47(b) (2) provided an exception for certain types of reorganizations which is not applicable herein (and the parties do not

Section 47(b) further provided:

> For purposes of subsection (a), property shall not be treated as ceasing to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as section 38 property and the taxpayer retains a substantial interest in such trade or business.

Section 47 sets out two prongs for the "mere change in the form" test--first, a continuing trade or business, and second, a retained substantial interest. The transactions herein clearly satisfy the continuing trade or business requirement. However, after the transaction in question, petitioner no longer had any interest in its former glass business; LOF Glass operated as a subsidiary of Pilkington Holdings. Thus, if section 47 were the only provision involved in this case, this lack of retained interest would be fatal to petitioner's position herein. Blevins v. Commissioner, 61 T.C. 547 (1974); Aboussie v. Commissioner, 60 T.C. 549 (1973), affd. without published opinion 504 F.2d 758 (5th Cir. 1974); Soares v. Commissioner, 50 T.C. 909 (1968); Purvis v. United States, 73-1 USTC par. 9157 (N.D. Ga. 1972).

However, the transactions herein took place in the consolidated return context, which provides a different frame of reference. Paragraph (f) of section 1.1502-3, Income Tax Regs., deals with early dispositions of section 38 assets of a member of a consolidated group; subparagraph (2) of paragraph (f) provides:

> (2) * * * a transfer of section 38 property from one member of the group to another member of such group during a consolidated return year shall not be

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argue otherwise) because the assets transferred to LOF Glass, Inc., did not constitute substantially all of the assets of petitioner. See Baicker v. Commissioner, 93 T.C. 316, 326 (1989).

> treated as a disposition or cessation within the meaning of section 47(a) (1). If such section 38 property is disposed of, or otherwise ceases to be section 38 property * * * before the close of the estimated useful life * * *, then section 47(a) (1) or (2) shall apply * * *

Subparagraph (3) of paragraph (f) provides:

> (3) Examples. The provisions of this paragraph may be illustrated by the following examples:
>
> Example (1). P, S, and T file a consolidated return for calendar year 1967. In such year S places in service section 38 property having an estimated useful life of more than 8 years. In 1968, P, S, and T file a consolidated return, and in such year S sells such property to T. Such sale will not cause section 47(a) (1) to apply.
>
> * * * *
>
> Example (3). Assume the same facts as in example (1), except that P, S, and T continue to file consolidated returns through 1971 and in such year T disposes of the property to individual A. Section 47(a) (1) will apply to the group * * *
>
> * * * *
>
> Example (5) . Assume the same facts as in example (1), except that in 1969, P sells all the stock of T to a third party. Such sale will not cause section 47(a) (1) to apply.

It is clear that the mere transfer of section 38 assets within a consolidated group does not trigger recapture. Sec. 1.1502-3(f) (2), Income Tax Regs.; see also sec. 47(b); Tandy Corp. v. Commissioner, 92 T.C. 1165 (1989); sec. 1.47-3(a), Income Tax Regs.

It is equally clear from Example (3) of the regulations that a transfer of the section 38 assets by LOF Glass, Inc., to

Pilkington Holdings would have triggered the recapture of the investment tax credit. In the same vein, the language of Example (5) without more would dictate that the transfer of the stock of LOF Glass, Inc., to Pilkington Holdings would not trigger the recapture of such credit. In point of fact, the application of Example (5) to the instant case is affected by a revenue ruling and the opinions of two Courts of Appeals approving that ruling. In order to facilitate an understanding of the positions of the parties and our views in respect thereto, we shall first discuss the ruling and the two Courts of Appeals opinions.

In Rev. Rul. 82-20, 1982-1 C.B. 6, section 38 assets were, pursuant to a prearranged plan, transferred by the parent corporation to a subsidiary within a consolidated group in exchange for stock of the subsidiary. Immediately thereafter, the stock of the subsidiary was distributed to one of the two shareholders in exchange for his stock in the parent. It was assumed that the subsidiary would continue to use the section 38 assets in the same trade or business. Although the ruling recognized that the transactions qualified under sections 355(c) (1) and 368(a) (1) (D), it held that the ITC recapture provision of section 47(a) (1) applied on the ground that there was a planned transfer of the property outside the group. Without making any reference to Example (5), the ruling reasons:

> Although section 1.1502-3(f) (2) (i) of the regulations creates an exception for transfers of section 38 property between members of a consolidated group that would otherwise be dispositions under section 47(a) (1), the exception is premised on the assumption that the property is remaining within the consolidated group. When there is no intention at the time of transfer to keep the property within the consolidated group, the transaction should be viewed as a whole and not as separate individual transactions. * * * [*Rev. Rul. 82-20, 1982-1 C.B. 7.]*

A factual situation similar to that involved herein was subjected to scrutiny by this Court in Walt Disney Inc. v. Commissioner, 97 T.C. 221 (1991), revd. 4 F.3d 735 (9th Cir. 1993). In holding that there was no ITC recapture upon the transfer of the shares of a subsidiary out of the consolidated group, we rejected respondent's argument that Example (5) was premised on the section 38 assets' remaining in the consolidated group and that there was no intention to observe this condition at the time the plans resulting in the transfer of the section 38 assets outside the consolidated group in Walt Disney Inc. were formulated. In so doing, we stated:

> Although the example (5) stock sale occurs in the year following the sale of the property within the affiliated group, there is nothing in section 1.1502-3(f) (2) (i) and (3), Income Tax Regs., requiring a minimum waiting period. Indeed, as little as a 1-day wait would be literally consistent with the examples in the regulation: the sale from S to T in example (1) could occur on December 31, 1968, and the sale of the S[T] stock out of the affiliated group in example (5) could occur on January 1, 1969. Nor is there any express requirement that the idea for the stock transfer arise after the sale of the property within the affiliated group. Thus, respondent's contention that the regulation is premised on the property remaining in the affiliated group is not apparent from the regulation itself. [Walt Disney Inc. v. Commissioner, 97 T.C. at 228.]

Based upon this analysis, we held that the regulation controlled, stating "When the authority to prescribe legislative regulations exists, this Court is not inclined to interfere if the regulations as written support the taxpayer's position." Id. We adopted this view even though an "unwarranted benefit to the taxpayer" might exist (id. at 229) and restated the position we had taken in Woods Investment Co. v. Commissioner, 85 T.C. 274, 281-282 (1985), that if respondent were dissatisfied with the import of a regulation, she should use her broad powers to amend the regulation and not look to the courts to do it for her. Although we made no specific reference to Rev. Rul. 82-

20, supra, it is clear that we rejected its reasoning by adhering to Example (5). Indeed, we reinforced such rejection by a lengthy discussion and rejection of the role of the so-called step transaction doctrine upon which Rev. Rul. 82-20 rested. See Walt Disney Inc. v. Commissioner, 97 T.C. at 231-236; see also Tandy Corp. v. Commissioner, supra, wherein we rejected the application of the step transaction doctrine to the issue of an ITC recapture in a nonconsolidated return situation.

The next development in the scenario involved herein is the decision of the Court of Appeals for the Second Circuit in Salomon, Inc. v. United States, 976 F.2d 837 (2d Cir. 1992). A factual situation substantially similar to that involved herein and in Walt Disney Inc. v. Commissioner, supra, confronted the Court of Appeals in Salomon. In deciding the case in favor of the Government, the Court of Appeals for the Second Circuit declared that the fact that, in Example (5), "the asset transfer occurs in one year (1968) and the spinoff in the next year (1969)", Salomon, Inc. v. United States, supra at 842, constituted a significant difference from the situation dealt with in Rev. Rul. 82-20, supra, and the Court of Appeals concluded:

> The Revenue Ruling thus complements CRR Example 5 by dealing with transactions that occur rapidly and are intended at their onset to transfer section 38 property outside the consolidated group. The consolidated return regulations state that "the Internal Revenue Code, or other law, shall be applicable to the group to the extent the regulations do not exclude its application." *Treas. Reg. § 1.1502-80* (emphasis added). *Revenue Ruling 82-20* is within the ambit of such "other law." We accordingly believe that the two rulings are not in conflict, and may consistently be read together. Judge Freeh did not err when he viewed the two rulings as alternatives and then chose *Revenue Ruling 82-20* based on EMC's intention

"immediately" to spin-off EC following the asset transfer. [Salomon, Inc. v. United States, 976 F.2d at 842-843.]

Having thus adopted the Government's position based upon its conclusion that Rev. Rul. 82-20, supra, was reasonable and consistent with prevailing law, the Court of Appeals for the Second Circuit declined to discuss whether the step transaction doctrine as such would, in any event, apply. Salomon, Inc. v. United States, supra at 843-844.

The final development in the scenario is the reversal of our decision in Walt Disney Inc. v. Commissioner, supra, by the Court of Appeals for the Ninth Circuit. Relying heavily upon Salomon, Inc. v. United States, supra, the Court of Appeals for the Ninth Circuit also concluded that Rev. Rul. 82-20, supra, and Example (5) were consistent and agreed with the Court of Appeals for the Second Circuit, with the further comment that Rev. Rul. 82-20 qualified as "other law" under section 1.1502-80, Income Tax Regs. Walt Disney Inc. v. Commissioner, 4 F.3d at 741 n.l0. The Court of Appeals for the Ninth Circuit made no reference to the step transaction doctrine.

Against the foregoing background, we proceed to consider the positions of the parties. Relying on the position we took in Walt Disney Inc. v. Commissioner, supra, petitioner contends that the regulations, section 1.1502-3(f)(2) and (3), and Example (5) in particular, Income Tax Regs., are dispositive and that the step transaction doctrine has no application herein. Respondent, relying on *Rev. Rul. 82-20,* supra, and the status accorded it by the Courts of Appeals for the Second and Ninth Circuits in Salomon, Inc. v. United States, supra, and Walt Disney Inc. v. Commissioner, supra, argues in effect that Rev. Rul. 82-20, supra, operates independently of Example (5) and should control and that, in any event, the application of the step transaction doctrine should result in the recapture by petitioner of the investment tax credit. We agree with petitioner.

With all due respect, we disagree with both the result and the reasoning of the Courts of Appeals and adhere to the position we took in Walt Disney Inc. v. Commissioner, 97 T.C. 221 (1991). We think that the fact that the transfer of the assets and the transfer of the stock occurred in the same, rather than different, taxable years does not provide a meaningful basis for distinguishing Rev. Rul. 82-20, supra, from Example (5) of the regulations. Indeed, as we have already pointed out, see supra pp. 9-10, we specifically refused to give weight to this element in Walt Disney Inc. v. Commissioner, supra. Our continued adherence to this point of view is reinforced by the fact that the time span element is also present in Example (3) where the section 38 assets are transferred in a different taxable year and the recapture of the investment tax credit is mandated. The contrast between these two examples highlights the fact that it is what is transferred and not when the transfer occurs that is significant. Indeed, if timing was a significant element in Example (5), one would think that respondent would have referred to Example (5) and this element in Rev. Rul. 82-20, supra, and thus provided the tax-paying public with notice of respondent's restrictive interpretation of Example (5) rather than leaving such interpretation to unarticulated alleged inference. We do not think the "assumption" referred to in the ruling, see supra p. 9, constitutes a meaningful signal to this effect.

In the foregoing context, the conflict between Rev. Rul. 82-20, supra, and Example (5) becomes apparent. The question then becomes what, if any, weight we should give to Rev. Rul. 82-20, supra. We think the Courts of Appeals for the Second and Ninth Circuits accorded the ruling undue weight and that revenue rulings play a lesser role than the language of the opinions of those Courts of Appeals seems to indicate. We see no purpose to be served in engaging in a detailed discussion of the differences in judicial articulation which can be found in this arena. We note, however, that the Court of Appeals for the Sixth Circuit, to which an appeal herein will lie, has stated:

> A Revenue Ruling, however, is not entitled to the deference accorded a statute or a Treasury Regulation. * * * [Threlkeld v. Commissioner, 848 F.2d 81, 84 (6th Cir. 1988), affg. 87 T.C. 1294 (1987).]

As we see it, Example (5) and not Rev. Rul. 82-20, supra, provides the key to decision herein. It may well be that Example (5) provides an unwarranted benefit to the taxpayer, but such a consideration was not sufficient to tip the scales in Woods Investment Co. v. Commissioner, 85 T.C. 274 (1985). See supra p. 10. We think as we did in Walt Disney Inc. v. Commissioner, supra, that the same approach applies herein. Respondent's remedy is not to seek to modify the regulation by judicial action or administrative ruling, but to change the regulation itself. See Walt Disney Inc. v. Commissioner, 97 T.C. at 229 (quoting at length from Woods Investment Co. v. Commissioner, 85 T.C. at 281-282)); see also Honeywell Inc. v. Commissioner, 87 T.C. 624, 635 (1986) (respondent had the right to amend the regulations but could not do so "by a revenue ruling or by judicial intervention"); Peninsula Steel Products & Equip. Co. v. Commissioner, 78 T.C. 1029, 1052 (1982) (ruling disapproved in light of regulation); Sims v. Commissioner, 72 T.C. 996, 1006 (1979) (rulings do not have the force of regulations).

Our approach herein obviously also reflects our disagreement with that of the Courts of Appeals for the Second and Ninth Circuits in according Rev. Rul. 82-20, supra, the status of "other law" in order to apply section 1.1502-80, Income Tax Regs. See supra p. 11. See Norfolk S. Corp. v. Commissioner, 104 T.C. 13, 45-46 (1995) (revenue rulings "do not have the force of law"), supplemented by 104 T.C. 417 (1995).

Finally, we turn to respondent's attempt to salvage her position by arguing that the step transaction doctrine constitutes "other law" within the meaning of section 1.1502-80(a), Income Tax Regs., which provides:

> The Internal Revenue Code, or other law, shall be applicable to the group to the extent the regulations do not exclude its application. * * *

We rejected respondent's attempt to invoke this provision in Walt Disney Inc. v. Commissioner, 97 T.C. at 231-236. In our opinion in that case, we set forth a detailed analysis of a factual situation substantially similar to that involved herein and concluded that there were no "meaningless or unnecessary steps" that should be ignored as required by the step transaction doctrine. We emphasized that respondent had blessed a reorganization plan. See id. at 225. We see no need to repeat that analysis herein where the facts are at least as strong as those which were involved in Walt Disney. In this connection, it is significant that in this case respondent has stipulated that the requirements of section 355 were met. By so doing, respondent has stipulated that there was a business purpose, i.e., substance, to the transfer by petitioner to LOF Glass, Inc., a position which is inconsistent with her position herein that petitioner disposed of the assets by in effect transferring them to Pilkington Holdings. Under these circumstances, we think that the analysis of the Courts of Appeals for the Second Circuit in Salomon, Inc. v. Commissioner, 976 F.2d 837 (1992), and the Ninth Circuit in Walt Disney Inc. v. Commissioner, supra, based on "economic reality" and "substance", which are key elements of the step transaction doctrine, misses the mark in terms of the proper disposition of this case. See Ginsburg & Levin, Mergers, Acquisitions and Buyouts, sec. 1002.1.1.4 (July 1996).

In sum, we hold for petitioner on the issue of the recapture of the investment tax credit. Such being the case, there is no addition to tax under section 6661. We again point out that this opinion resolves only the investment tax credit recapture issue and that an additional issue relating to the allocation of deductions is still before the Court. See supra note 2.

Reviewed by the Court.

COHEN, CHABOT, GERBER, PARR, WHALEN, COLVIN, CHIECHI, LARO, FOLEY, and GALE, JJ., agree with this majority opinion.

HALPERN, J., did not participate in the consideration of this opinion.

SWIFT, J.,respectfully dissenting:

With the benefit of the analyses provided in the opinions of the Second and Ninth Circuit Courts of Appeals in Salomon, Inc. v. United States, 976 F.2d 837 (2d Cir. 1992), and Walt Disney, Inc. v. Commissioner, 4 F.3d 735 (9th Cir. 1993), we should recognize the error made in our opinion in Walt Disney, Inc. v. Commissioner, 97 T.C. 221 (1991), and sustain respondent's position in this case.

The majority suggests that the issue herein turns primarily on whether a particular provision of the consolidated return regulations (namely, sec. 1.1502-3(f) (3), Example (5), Income Tax Regs.) controls over a revenue ruling (namely, Rev. Rul. 82-20, 1982-1 C.B. 6). The majority argues that the above Courts of Appeals, in the cited opinions, give undue weight to the revenue ruling and ignore what the majority regards as the clear mandate of the regulation under section 1502.

The majority is correct in stating that revenue rulings do not generally constitute legal precedent or "other law". As the language quoted below, however, from each of the cited opinions indicates, neither the U.S. Courts of Appeals for the Second nor the Ninth Circuit rely exclusively on the conclusive effect of the revenue ruling. Rather, both rely heavily on "economic reality" and the "substance-over-form" doctrines, which are simply broader labels for, and which encompass, the step transaction doctrine.

The Court of Appeals for the Second Circuit in Salomon, Inc. v. United States, supra at 842-843, explained as follows:

> In substance, if not in form, the direct and the circuitous transaction are the same. See

> Commissioner v. Court Holding Co., 324 U.S. 331, 334, 65 S. Ct. 707, 708, 89 L. Ed. 981 (1945). Each achieves a rapid transfer of section 38 property outside the group. To distinguish between them would deny economic reality. See Gregory v. Helvering, 293 U.S. 465, 470, 55 S. Ct. 266, 268, 79 L. Ed. 596 (1935) (refusing to "exalt artifice above reality" in determining tax liability). Moreover, such a holding would allow the common parent of a consolidated group, such as * * * [the parent], to move section 38 property outside the group without paying recapture taxes simply by first transferring the property to a member subsidiary and then distributing the subsidiary's stock to the third-party. * * *
>
> * * * *
>
> The rapidity with which these components follow one another suggest that they are, in substance, parts of one overall transaction intended to dispose of the section 38 assets outside of the consolidated group. * * * These factual circumstances, timing and intent * * *. * * * lead to the conclusion that the two components are steps in a larger transaction which, when viewed as a whole, constitutes a section 47 (a) (1) "disposition." * * *
>
> * * * *
>
> Under these circumstances, the transaction is, in substance, a means of moving the assets outside the group. * * *

The Court of Appeals for the Ninth Circuit in Walt Disney, Inc. v. Commissioner, supra at 741, relied heavily upon the analysis of the Court of Appeals for the Second Circuit, quoted from the above language, and stated the following --

> "in substance, if not in form, the direct and the circuitous transaction are the same" and "to

> distinguish between them would deny economic reality" and would allow the common parent of a consolidated group to circumvent easily the recapture requirement. * * *

The position we adopted in our opinion in Walt Disney, Inc. v. Commissioner, 97 T.C. at 221, failed to apply properly the substance-over-form doctrine and failed to give proper weight to section 1.47-3(f) (1), Income Tax Regs., which provides clearly that to the extent ownership of an affiliated transferee corporation changes hands as part of the transfer of property to the transferee corporation, a taxable disposition has occurred under section 47. See sec. 1.47-3(f) (1), (2), (6) Examples (2), (3), and (4), Income Tax Regs.

The above regulations under section 1.47-3(f) (1), (2) (6), should be read together with section 1.1502-3(f) (3), Income Tax Regs. Where a change in ownership of an affiliated transferee company is contemplated at the time of a transfer of section 38 property and where the change in ownership that occurs is, in substance, in economic reality, and/or under the step transaction doctrine, integral to the transfer of the property outside the affiliated group, the transfer should be treated, to the extent of the change in ownership of the transferee corporation, as a taxable disposition under section 47.

The weight to be given a revenue ruling is not the issue in this case. Rather, the issue is the validity of the underlying rationale of Rev. Rul. 82-20, 1982-1 C.B. 6, -- namely, whether the transaction before us and its taxability under section 47 is controlled by the substance thereof. As is explained in the cited ruling:

> When there is no intention at the time of transfer to keep the property within the consolidated group, the transaction should be viewed as a whole and not as separate individual transactions. * * *
>
> Because the transfer * * * is a step in the planned transfer of the property outside the group, section

> 1.1502-3(f) (2) (i) of the regulations does not apply. [Rev. Rul. 82-20, 1982-1 C.B. 6; citations omitted.]

In Tandy Corp. v. Commissioner, 92 T.C. 1165 (1989), we held that, on the particular facts of that case, recapture under section 47 was not appropriate where a change in ownership of a transferee corporation occurred in a year after a transfer of property to the transferee corporation. With respect, however, to a fact situation similar to the instant case (where a transfer of property and an ownership change in the transferee corporation effectively occur during the same taxable year and as part of the same integral transaction), we explained in Tandy Corp. v. Commissioner, supra, that section 47 recapture would be triggered, as follows:

> To treat * * * [the taxpayer] as having relinquished during the year before the Court a "substantial interest" as contemplated by section 1.47-3(f) (1) (ii) (b), Income Tax Regs., would require a concomitant finding that such an interest passed to * * * [the taxpayer's] shareholders at the same time. * * * [Id. at 1171.]

The majority op. pp. 15-16 implicitly acknowledges that the substance-over-form and step transaction doctrines have application as "other law" in the consolidated return context under section 1.1502-80, Income Tax Regs. The majority, however, summarily dismisses the application of such doctrines to the specific facts of this case because each step of the reorganization plan adopted by petitioner had a business purpose.

Both the Second and the Ninth Circuit Courts of Appeals in the above-cited opinions applied the substance-over-form doctrine in spite of the presence of a business purpose for each step of the reorganizations involved in those cases and, as stated above, concluded that the substance thereof, for purposes of section 47, constituted dispositions of property outside the consolidated group, thus triggering recapture under section 47. See also the District Court's opinion in

Salomon v. United States, 92-1 USTC par. 50,155, 70 AFTR 2d par. 92-5872 (S.D.N.Y. 1992).

In King Enters., Inc. v. United States, 189 Ct. Cl. 466, 418 F.2d 511, 516 n.6 (1969), the Court of Claims explained that various courts have --

> enunciated a variety of doctrines, such as step transaction, business purpose, and substance over form. Although the various doctrines overlap and it is not always clear in a particular case which one is most appropriate, their common premise is that the substantive realities of a transaction determine its tax consequences.

With regard more specifically to the question of the relationship between the step transaction doctrine and the business purpose aspect of a transaction and in the context of analyzing a section 332 liquidation, the Court of Appeals for the Tenth Circuit in Associated Wholesale Grocers, Inc. v. United States, 927 F.2d 1517 (10th Cir. 1991), rejected the contention that a valid business purpose precludes application of the step transaction doctrine. The Court of Appeals explained as follows:

> Most cases applying the step transaction doctrine, far from identifying business purpose as an element whose absence is prerequisite to that application, do not even include discussion of business purpose as a related issue. In some cases, the existence of a business purpose is considered one factor in determining whether form and substance coincide. In others, the lack of business purpose is accepted as reason to apply the step transaction doctrine. We have found no case holding that the existence of a business purpose precludes the application of the step transaction doctrine. [Associated Wholesale Grocers, Inc. v. United States, 927 F.2d at 1526-1527; fn. refs. omitted.]

The Court of Appeals for the Tenth Circuit in Associated Wholesale Grocers., Inc. v. United States, supra at 1527 n.15, also cited our opinion in Vest v. Commissioner, 57 T.C. 128 (1971), revd. in part and affd. in part on other grounds 481 F.2d 238 (5th Cir. 1973), and commented thereon as follows:

> After identifying a business purpose, the * * * [Tax Court in Vest v. Commissioner] undertakes a thorough discussion of whether to treat a stock exchange as a step transaction. *57 T.C. at 145.* The * * * [Tax Court] remarked "the fact that there were business purposes for the incorporation of V Bar is an indication that its formation was not a step mutually interdependent with the subsequent stock exchange" and continued to consider other factors, including the existence of a binding commitment, the timing of the steps, and the actual intent of parties. Id. at 145-46. (Emphasis added [by Tenth Circuit]). Far from precluding step transaction analysis, the business purpose was not even considered the most significant factor in Vest. * * *

In Yoc Heating Corp. v. Commissioner, 61 T.C. 168, 177 (1973) (Court reviewed), we expressly commented on the relationship between the step transaction doctrine and the business purpose aspect of a transaction, and we did so in the particular context of the reorganization provisions of the Code, which were also involved in that case, as follows:

> Our path to decision is framed within two cardinal principles, which apply in the reorganization area and which are so well established as not to require supporting citations. First, the fact that the form of the transaction conforms to the literal wording of the definition of a reorganization is not controlling. Second, when a transaction is composed of a series of interdependent steps, each undertaken to achieve an overall objective, the various steps should be viewed in their entirety for the purpose of determining its tax consequences--the so-called

> "integrated transaction" doctrine. * * * The fact that for valid business reasons there was a delay of several months before * * * [the new entity] came into existence and completed the acquisition does not militate against * * * [application of the step transaction doctrine]. [Citations omitted.]

It is acknowledged that the Commissioner in Rev. Rul. 79-250, 1979-C.B. 156, suggested that, in the context of certain reorganization transactions, preliminary and related transactions or steps will not necessarily be stepped together and ignored where each such preliminary step constitutes a permanent alteration of a previous bona fide business relationship. That general statement in Rev. Rul. 79-250, however, does not preclude application of the step transaction doctrine, the substance over form doctrine, or the integrated transaction doctrine to the facts of this case involving recapture of investment tax credit under section 47. See also Associated Wholesale Grocers., Inc. v. United States, supra at 1526-1527; Rev. Rul. 96-29, 1996-24 I.R.B. 5.

Based on the above authority, I believe that the majority herein errs in suggesting, majority op. p. 16, that the business purpose associated with the transfer of petitioner's glass division to a subsidiary and with the change in ownership of the subsidiary provides, for purposes of section 47 recapture, the sum and substance of the transaction before us and effectively precludes any meaningful analysis under the substance-over-form, the step transaction, or the integrated transaction doctrines.

A brief analysis of the substance and steps of the transactions before us is appropriate.

The Court of Appeals for the Sixth Circuit, to which an appeal in this case would lie, has adopted the end result approach of the step transaction doctrine. In Brown v. United States, 868 F.2d 859, 862-863 (6th Cir. 1989), the Court of Appeals for the Sixth Circuit stated as follows --

> the essence of the step transaction doctrine is that an "integrated transaction must not be broken into independent steps or, conversely, that the separate steps must be taken together in attaching tax consequences". * * *
>
> * * * *
>
> Under the end result test of the step transaction doctrine, "purportedly separate transactions will be amalgamated into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result." King Enters. Inc. v. United States, 418 F.2d at 516. * * *

Here the parties have stipulated the following facts with regard to the transfer of LOF's glass division and the change in ownership of LOF Glass.

Late in 1985, representatives of Pilkington approached LOF concerning acquisition of LOF's glass division. During November of 1985 through early March of 1986, negotiations regarding the possible acquisition took place.

On March 6, 1986, LOF transferred the glass division to LOF Glass, the new subsidiary that had been formed for that purpose. One day later, on March 7, 1986, LOF entered into a 45-page agreement to transfer to Pilkington Holdings all of its stock interest in LOF Glass in exchange for Pilkington Holdings' stock interest in LOF.

The March 7, 1986, agreement to exchange stock expressly refers to the March 6, 1986, transfer of the glass division to LOF Glass and establishes the integrated nature of these transactions.

Seven weeks later, on April 28, 1986, the exchange of stock that had been agreed to on March 7, 1986, was consummated.

After April 28, 1986, LOF Glass was no longer part of LOF's affiliated group and no longer was included in LOF's consolidated Federal income tax return.

It is apparent that the transfer of the glass division to LOF Glass and the agreement one day later to transfer the stock of LOF Glass outside the LOF affiliated group constituted an integrated transaction intended to move the glass division (and the related section 38 property) outside of LOF's affiliated group.

Based on this stipulated factual record and on this issue on which petitioner has the burden of proof (see Rule 142(a)), only one conclusion can be reasonably reached -- namely, that in spite of the qualification of the transaction as a reorganization under section 368(a) (1) (D) (allowing LOF to avoid recognizing taxable gain or loss on the transfer of the glass business and allowing LOF and Pilkington Holdings to avoid recognizing taxable gain or loss on their exchange of stock), the substance of the integrated transaction by which LOF's glass division in 1986 was transferred outside the LOF affiliated group constituted a disposition of property under section 47 and triggered recapture of investment tax credit on any section 38 property that was included with the property transferred.

Section 1.1502-3(f) (3), Example (5), Income Tax Regs., simply is not applicable. That example involved, in year 1, only a transfer of property within the affiliated group. After the transfer, the property stayed within the affiliated group and was included in the consolidated return for the remainder of year 1. In year 2, no further transfer of property occurred. Rather, in an apparently unrelated transaction, a third party purchased the stock of the transferee, and the transferee, which had received the property in year 1, left the affiliated group. For the first time in year 2, the property will not be included in the consolidated return of the affiliated group.

The transaction described in Example (5) of the above regulation bears little resemblance to that involved in this case

(where a transfer of property and a change in ownership of the transferee corporation occur effectively within the same taxable year as part and parcel of a single plan and transaction under which the transferee corporation promptly leaves the affiliated group and is no longer part of the affiliated group for purposes of inclusion in the transferor corporation's consolidated tax return) . Example (5) of the above regulation under the consolidated return regulations should not be read to immunize the integrated transaction before us from recapture under section 47.

It bears noting that the facts of the instant transaction are distinguishable from the facts of Salomon v. Commissioner, 976 F.2d 837 (2d Cir. 1992), and Walt Disney, Inc. v. Commissioner, 4 F.3d 735 (9th Cir. 1993). Although the spin-offs in those cases resulted in a change in the identity of the corporate holder of the section 38 property, that property remained in the same economic family, with the same shareholders holding the stock of the new corporate owner of the section 38 property. In the instant case, at the inception of the transactions, Pilkington held only a 29-percent interest in the stock of LOF. As a result of the completion of the split off, Pilkington acquired a 100-percent interest in the stock of LOF Glass, reflecting a 71-percent shift in the ownership of the corporation owning the section 38 property after the split off.

For the reasons stated herein and in the above opinions of the courts of appeals, I dissent.

JACOBS, WELLS, RUWE, BEGHE, and VASQUEZ JJ. agree with this dissent.

BEGHE, J., dissenting:

Having joined Judge Swift's dissent, I add a few words in an effort to provide some further support and explanation. The case at hand is an appropriate occasion to apply the intent, end result, integrated transaction version of the step-transaction doctrine to support a finding of early disposition that results in ITC recapture.

Petitioner's initial drop-down to LOF Glass of the glass business and its section 38 assets, which occurred on March 6, 1986, was followed 1 day later by the single-spaced, 45-page, March 7, 1986, agreement for the split-off exchange of shares of petitioner for shares of LOF Glass by Pilkington Holdings. The split-off occurred on April 28, 1986, pursuant to that agreement, as amended in immaterial respects. Although the parties stipulated that the drop-down occurred for valid business reasons, reasons that were presumably independent of the impending divestiture, there were no substantial conditions in the March 7, 1986, agreement to consummation of the split-off.[4]

The majority, uncritically following our opinion in Walt Disney, Inc. v. Commissioner, 97 T.C. 221 (1991), revd. 4 F.3d 735 (9th Cir. 1993), assumes an unwarranted equivalence between the two events described in the section 1502 regulation examples and the LOF Glass divestiture transaction.[5] Contrary to the majority's assumption, the unadorned descriptions of the events in the regulation's two examples indicate the lack of connection between the intragroup sale of section 38 assets in year 1 and the sale of the stock of the purchaser to a third party outside the group in

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[4] Expiration of all Hart-Scott-Rodino waiting periods, receipt of tax opinions that the split-off would be a tax-free exchange under section 355, and satisfaction of all other stated conditions, must have occurred or have been waived between March 6 and April 28, 1986.

[5] There are at least three significant differences between the facts of the examples in the section 1502 regulation and the facts of our case. In the examples, the sale of the section 38 assets and the sale of the purchaser's stock occur in different tax years, whereas in our case they occur in the same year; the first sale in the examples appears to be made to a preexisting member of the group, whereas in our case the transfer is made to a newly created subsidiary organized to do the deal, including the second step; and the examples concern two unrelated sales, whereas the first transaction in our case is a drop-down of assets that is an integral and necessary step of the plan to accomplish the agreed upon tax-free split-off exchange of shares that is intended to follow.

year 2. The majority goes on to disregard the obvious connection--supplied by the intent, manifested contemporaneously with the drop-down to LOF Glass, to accomplish the end result of the split-off--that binds the steps in the case at hand in an integrated transaction.[6]

The transactions in the case at hand are not just two unconnected sales. They evidence a flow of events that comprise a two-step divestiture, the second step of which is an exchange of shares under section 368(a) (1) (D) that qualifies for nonrecognition under section 355. The initial drop-down of assets into a subsidiary in exchange for its shares is essential to enable the intended divestiture to be accomplished by a share for share exchange that entitles the second step to nonrecognition of gain to both parties. The connection that binds the two steps, as in J.E. Seagram Corp. v. Commissioner, 104 T.C. 75, 91-99 (1995), is manifested in the plan of reorganization, which embodies the intent to achieve the end result.[7] Although the first step in the case at hand has an independent business purpose in the sense that it would not have been fruitless in all events to take that step--after all, a corporation engaged in more than one business almost invariably has a business purpose for dropping a business into a subsidiary, if only to protect the assets of its other businesses from the liabilities and risks that are

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[6] Events should be deemed to have a connection for tax purposes when dictated by the logic of events that has to do with cause and effect relationships and necessary connections or outcomes. Under that formulation, there is no connection between the sales in the examples in the sec. 1502 regulation and there is a connection between the drop-down and the split-off in the case at hand.

[7] Contrary to the views of those who would read the intent, end result, integrated transaction version of the step-transaction doctrine out of the judicial arsenal, see, e.g., Ginsburg & Levin, Mergers, Acquisitions and Buyouts, secs. 208.4.5, 608.1, 608.3.1, 610.9, 1002.1.4 (July 1996); Bowen, "The End Result Test," 49 Taxes 722 (1994), there is an appropriate role for this "weak" version of the step-transaction doctrine in situations such as the case at hand.

encapsulated by the drop-down--the independent business purpose of the first step in the case at hand is trumped by the more important business purpose of completing the divestiture by means of a tax-free exchange, which relegates the first step to a subordinate implementing role. The integrated transaction approach is a legitimate "weak" version of the step-transaction doctrine, as contrasted with the strong" requirements[8] that must be satisfied, under its binding commitment and interdependence versions, in order to disregard unnecessary intermediate steps.[9] The creation of and drop-down to LOF Glass were necessary to accomplish the divestiture separating LOF Glass, the new holder of the glass business and its section 38 assets, from the affiliated group), which was the intended end result that followed the initial step. The intention to effect that end result suffices to justify application of the integrated transaction approach to conclude that the section 38 assets left the economic family of petitioner's affiliated group in a way that requires ITC recapture.

JACOBS, J., agrees with this dissent.

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[8] The terms "weak" and "strong" are used here in the mathematical sense of "subject to less/more exacting or numerous conditions". See Oxford English Dictionary, Entries under "weak", 19.f(b) and "strong", 19.c (2d ed. 1995). Analogous usages occur in logic, physics, and cosmology. On "weakened" and "strengthened" moods of the syllogism, see Cohen & Nagel, An Introduction to Logic and Scientific Method 84, 86 (1934). On the "strong" force in elementary particle physics, which holds the nucleus together, and the "weak" force, which causes the decay of many of the elementary particles, see, e.g., 28 Encyclopedia Britannica, "Subatomic Particles" 239-240 (15th ed. 1993). On the "weak" and "strong" anthropic principles regarding the state of the universe, see Hawking, A Brief History of Time 124-126 (1988). See also Penrose, The Emperor's New Mind 17-23 (1989), on "strong" artificial intelligence.

[9] As in West Coast Mktg. Corp. v. Commissioner, 46 T.C. 32 (1966).

APPENDIX D

In the United States Tax Court

No. 2931-94

AEROQUIP-VICKERS, INC. AND SUBSIDIARIES,
formerly known as Trinova Corporation and Subsidiaries,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ENTERED: October 1, 2001

DECISION

Cohen, J.

Pursuant to the opinions of the Court filed February 27, 1997, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there is an overpayment in income tax for the taxable year 1985 in the amount of $21,025.00, which amount was paid on September 15, 1986, and for which amount a claim for refund could have been filed, under the provisions of I.R.C. § 6511(c), on November 26, 1993, the date of the mailing of the notice of deficiency;

That there is an overpayment in income tax for the taxable year 1986 in the amount of $5,158,379.60, of which amount $5,147,583.60 was paid on February 1, 1993, and of which amount $10,796.00 was paid on December 15, 1986, and for which amount a claim for refund could have been filed, under the provisions of I.R.C. § 6511(c), on November 26, 1993, the date of the mailing of the notice of deficiency;

That there is an overpayment in income tax for the taxable year 1987 in the amount of $2,483,399.00, which amount was paid on February 1, 1993, and for which amount a claim for refund could have been filed, under the provisions of I.R.C. § 6511(c), on November 26, 1993, the date of the mailing of the notice of deficiency; and

That there is an overpayment in income tax for the taxable year 1988 in the amount of $111,519.00, which amount was paid on February 1, 1993, and for which amount a claim for refund could have been filed, under the provisions of I.R.C. § 6511(c), on November 26, 1993, the date of the mailing of the notice of deficiency.

Entered:

The parties stipulate that the foregoing decision is in accordance with the opinions of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

RICHARD W. SKILLMAN
Acting Chief Counsel
Internal Revenue Service

/s/ Frederick E. Henry
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Date: September 20, 2001

APPENDIX E

26 U.S.C. §38

§ 38. GENERAL BUSINESS CREDIT.

(a) Allowance of Credit.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

(1) the business credit carryforwards carried to such taxable year,

(2) the amount of the current year business credit, plus

(3) the business credit carrybacks carried to such taxable year.

(b) Current Year Business Credit.—For purposes of this subpart, the amount of the current year business credit is the sum of the following credits determined for the taxable year:

(1) the investment credit determined under section 46(a),

(2) the targeted jobs credit determined under section 51(a),

(3) the alcohol fuels credit determined under section 40(a), plus

(4) the employee stock ownership credit determined under section 41(a).

(c) Limitation based on amount of tax.—

(1) In General.—The credit allowed under subsection (a) for any taxable year shall not exceed the sum of—

(A) so much of the taxpayer's net tax liability for the taxable year as does not exceed $25,000, plus

(B) 85 percent of so much of the taxpayer's net tax liability for the taxable year as exceeds $25,000.

(2) Net Tax Liability.—For purposes of paragraph (I), the term "net tax liability" means the tax liability (as defined in section 26(b)), reduced by the sum of the credits allowable under sub-parts A and B of this part.

(3) Special Rules.—

(A) Married Individuals.—In the case of a husband or wife who files a separate return, the amount specified under subparagraphs (A) and (B) of paragraph (1) shall be $12,500 in lieu of $25,000. This subparagraph shall not apply if the spouse of the taxpayer has no business credit carryforward or carryback to, and has no current year business credit for, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

(B) Controlled Groups.—In the case of a controlled group, the $25,000 amount specified under subparagraphs (A) and (B) of paragraph (1) shall be reduced for each component member of such group by apportioning $25,000 among the component members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of the preceding sentence, the term "controlled group" has the meaning given to such term by section 1563(a).

(C) Limitations With Respect to Certain Persons.—In the case of a person described in subparagraph (A) or (B) of section 46(e)(l), the $25,000 amount specified under subparagraphs (A) and (B) of paragraph (1) shall equal such person's ratable share (as determined under section 46(e)(2)) of such amount.

(D) Estates and Trusts.—In the case of an estate or trust, the $25,000 amount specified under subparagraphs (A) and (B) of paragraph (1) shall be reduced to an amount which bears the same ratio to $25,000 as the portion of the income of the estate or trust which is not allocated to beneficiaries bears to the total income of the estate or trust.

(d) Special Rules for Certain Regulated Companies.—In the case of any taxpayer to which section 46(f) applies, for purposes of sections 46(f), 47(a), 196(a), and 404(i) and any other provision of this title where it is necessary to ascertain the extent to which the credits determined under section 40(a), 41(a), 46(a), or 51(a) are used in a taxable year or as a carryback or carryforward, the order in which such credits are used shall be determined on the basis of the order in which they are listed in subsection (b).

APPENDIX F

26 U.S.C. §46

§ 46. AMOUNT OF CREDIT.

(e) Amount of Investment Credit.—For purposes of section 38, the amount of the investment credit determined under this section for any taxable year shall be an amount equal to the sum of the following percentages of the qualified investment (as determined under subsections (c) and (d)):

(1) the regular percentage,

(2) in the case of energy property, the energy percentage, and

(3) in the case of that portion of the basis of any property which is attributable to qualified rehabilitation expenditures; the rehabilitation percentage.

Determination of Percentages.—For purposes of subsection (a)—

(1) Regular Percentage.—The regular percentage is 10 percent.

(2) Energy percentage.—

(A) In General.—The energy percentage shall be determined in accordance with the following table:

Column A—Description	Column B—Percentage	Column C—Period	
		For the period:	
In the case of:	The energy percentage is:	Beginning on:	And ending on:
(i) GENERAL RULE.—Property not described in any of the following provisions of this column.	10 percent	Oct. 1, 1978	Dec. 31, 1982
(ii) SOLAR WIND, OR GEOTHERMAL PROPERTY.—Property described in section 48(*l*)(2)(A)(ii) or 48(*l*)(3)(A)(vii).	A. 10 percent	Oct. 1, 1978	Dec. 31, 1979
	B. 15 percent	Jan. 1, 1980	Dec. 31, 1985
(iii) OCEAN THERMAL PROPERTY.—Property described in section 48(*l*)(3)(A)(ix).	15 percent	Jan. 1, 1980	Dec. 31, 1985
(iv) QUALIFIED HYDROELECTRIC GENERATING PROPERTY.—Property described in section 48(*l*)(2)(A)(vii).	11 percent	Jan. 1, 1980	Dec. 31, 1985

Column A—Description	Column B—Percentage	Column C—Period	
In the case of:	The energy percentage is:	For the period: Beginning on:	And ending on:
(v) QUALIFIED INTERCITY BUSES.—Property described in section 48(*l*)(2)(A)(ix).	10 percent	Jan. 1, 1980	Dec. 31, 1985
(vi) BIOMASS PROPERTY.—Property described in section 48(*l*)(15).	10 percent	Oct. 1, 1978	Dec. 31, 1985
(vii) CHLOR-ALKALI ELECTROLYTIC CELLS.—Property described in section 48(*l*)(5)(M).	10 percent	Jan. 1, 1980	Dec. 31, 1985

(B) Periods for Which Percentage Not Specified.—In the case of any energy property, the energy percentage shall be zero for any period for which an energy percentage is not specified for such property under subparagraph (A) (as modified by subparagraphs (C) and (D)).

(C) Longer Period for Certain Long-term Projects.—For the purpose of applying the energy percentage contained in clause (i) of subparagraph (A) with respect to property which is part of a project with a normal construction period of 2 years or more (within the meaning of subsection (d)(2)(A)(i)), "December 31, 1990" shall be substituted for "December 31, 1982" if—

(i) before January 1, 1983, all engineering studies in connection with the commencement of the construction of the project have been completed and all environmental and construction permits required under Federal, State, or local law in connection with the commencement of the construction of the project have been applied for, and

(ii) before January 1, 1986, the taxpayer has entered into binding contracts for the acquisition, construction, reconstruction, or erection of equipment specially designed for the project and the aggregate cost to the taxpayer of that equipment is at least 50 percent of the reasonably estimated cost for all such equipment which is to be placed in service as part of the project upon its completion.

(D) Longer Period for Certain Hydroelectric Generating Property.—If an application has

been docketed by the Federal Energy Regulatory Commission before January 1, 1986, with respect to the installation of any qualified hydroelectric generating property, for purposes of applying the energy percentage contained in clause (iv) of subparagraph (A) with respect to such property, "December 31, 1988" shall be substituted for "December 31, 1985".

(3) Special Rule for Certain Energy Property.—The regular percentage shall not apply to any energy property which, but for section 48(*l*)(1), would not be section 38 property. In the case of any qualified hydroelectric generating property which is a fish passageway, the preceding sentence shall not apply to any period after 1979 for which the energy percentage for such property is greater than zero.

(4) Rehabilitation percentage.—

In general.—

In the case of qualified rehabilitation expenditures with respect to a:	The rehabilitation percentage is:
30-year building	15
40-year building	20
Certified historic structure	25

(B) Regular and Energy Percentages Not to Apply.—The regular percentages and the energy percentages shall not apply to that portion of the basis of any property which is attributable to qualified rehabilitation expenditures.

(C) Definitions.—For purpose of this paragraph—

(i) 30-YEAR BUILDING.—The term "30-year building" means a qualified rehabilitated building other than a 40-year building and other than a certified historic structure.

(ii) 40-Year Building.—The term "40-year building" means a qualified rehabilitated building (other than a certified historic structure) which would meet the requirements of section 48(g)(l)(B) if "40" were substituted for "30" each place it appears in subparagraph (B) thereof.

(iii) Certified Historic Structure.—The term "certified historic structure" means a qualified rehabilitated building which meets the requirements of section 48(g)(3).

(g) Qualified investment.—

(1) In General.—For purposes of this subpart, the term "qualified investment" means, with respect to any taxable year, the aggregate of-

(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year, plus

(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48(c)(1)) placed in service by the taxpayer during such taxable year.

(2) Applicable percentage in certain cases.-Except as provided in paragraphs (3), (6), and (7), the

applicable percentage for purposes of paragraph (1) for any property shall be determined under the following table:

If the useful life is—	The applicable percentage is—
3 years or more but less than 5 years	33
5 years or more but less than 7 years	66
7 years or more	100

For purposes of this subpart, the useful life of any property shall be the useful life used in computing the allowance for depreciation under section 167 for the taxable year in which the property is placed in service.

(3) Public utility property.—

(A) To the extent that the credit allowed by section 38 with respect to any public utility property is determined at the rate of 7 percent, in the case of any property which is public utility property, the amount of the qualified investment shall be $^4/_7$ of the amount determined under paragraph (1). The preceding sentence shall not apply for purposes of applying the energy percentage.

(B) For purposes of subparagraph (A), the term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of—

(i) electrical energy, water, or sewage disposal services,

(ii) gas through a local distribution system, or

(iii) telephone service, telegraph service by means of domestic telegraph operations (as defined in section 222(a)(5) of the Communications Act of 1934, as amended; 47 U.S.C. 222(a)(5)), or other communication services (other than international telegraph service), if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof. Such term also means communication property of the type used by persons engaged in providing telephone or microwave communication services to which clause (iii) applies, if such property is used predominantly for communication purposes.

(C) In the case of any interest in a submarine cable circuit used to furnish telegraph service between the United States and a point outside the United States of a taxpayer engaged in furnishing international telegraph service (if the rates for such furnishing have been established or approved by a governmental unit, agency, instrumentality, commission, or similar body described in subparagraph (B)), the qualified investment shall not exceed the qualified investment attributable to so much of the interest of the taxpayer in the circuit as does not

exceed 50 percent of all interests in the circuit.

(4) Coordination With Subsection (D).—The amount which would (but for this paragraph) be treated as qualified investment under this subsection with respect to any property shall be reduced (but not below zero) by any amount treated by the taxpayer or a predecessor of the taxpayer (or, in the case of a sale and leaseback described in section 47(a)(3)(C), by the lessee) as qualified investment with respect to such property under subsection (d), to the extent the amount so treated has not been required to be recaptured by reason of section 47(a)(3).

(5) Applicable percentage in the case of certain pollution control facilities.—

(A) In General.—Notwithstanding paragraph (2), in the case of property—

(i) with respect to which an election under section 169 applies, and

(ii) the useful life of which (determined without regard to section 169) is not less than 5 years.

100 percent shall be the applicable percentage for purposes of applying paragraph (1) with respect to so much of the adjusted basis of the property as (after the application of section 169(f)) constitutes the amortizable basis for purposes of section 169.

(B) Special Rule Where Property is Financed by Industrial Development Bonds.—To the extent that any property is financed by the proceeds of an industrial development bond (within the meaning of section 103(b)(2)) the interest on which is exempt from tax under section 103, subparagraph

(A) shall be applied by substituting "50 percent" for "100 percent". This subparagraph shall not apply for purposes of applying the energy percentage.

(6) Special rule for commuter highway vehicles.—

(A) In General.—Notwithstanding paragraph (2) or (3), in the case of a commuter highway vehicle the useful life of which is 3 years or more, or which is recovery property (within the meaning of section 168), the applicable percentage for purposes of paragraph (1) shall be 100 percent.

(B) Definition of Commuter Highway Vehicle.—For purposes of subparagraph (A), the term "commuter highway vehicle" means a highway vehicle—

(i) the seating capacity of which is at least 8 adults (not including the driver),

(ii) at least 80 percent of the mileage use of which can reasonably be expected to be (I) for purposes of transporting the taxpayer's employees between their residences and their place of employment, and (11) on trips during which the number of employees transported for such purposes is at least one-half of the adult seating capacity of such vehicle (not including the driver),

(iii) which is acquired by the taxpayer on or after the date of the enactment of the Energy Tax Act of 1978, and

placed in service by the taxpayer before January 1, 1986, and

(iv) with respect to which the taxpayer makes an election under this paragraph on his return for the taxable year in which such vehicle is placed in service.

(7) Applicable Percentage for Recovery Property.—Notwithstanding paragraph (2), the applicable percentage for purposes of paragraph (1) shall be—

(A) in the case of recovery property other than &year property (within the meaning of section 168(c)), 100 percent, and

(B) in the case of 3-year property (within the meaning of section 168(c)), 60 percent.

For purposes of subparagraph (A), RRB replacement property (within the meaning of section 168(f)(3)(B)) shall be treated as property which is not 3-year property.

(8) Certain nonrecourse financing excluded from credit base.—

(A) Limitation.—The credit base of any property to which this paragraph applies shall be reduced by the nonqualified nonrecourse financing with respect to such property (as of the close of the taxable year in which placed in service).

(B) Property to Which Paragraph Applies.—This paragraph applies to any property which—

(i) is placed in service during the taxable year by a taxpayer described in section 465(a)(1), and

(ii) is used in connection with an activity with respect to which any loss is subject to limitation under section 465.

(C) Credit Base Defined.—For purposes of this paragraph, the term "credit base" means—

(i) in the case of new section 38 property, the basis of the property, or

(ii) in the case of used section 38 property, the cost of such property.

(D) Nonqualified nonrecourse financing.—

(i) In General.—For purposes of this paragraph and paragraph (9), the term "nonqualified nonrecourse financing" means any nonrecourse financing which is not qualified commercial financing.

(ii) Qualified Commercial Financing.—For purposes of this paragraph, the term "qualified commercial financing'' means any financing with respect to any property if—

(I) such property is acquired by the taxpayer from a person who is not a related person,

(II) the amount of the nonrecourse financing with respect to such property does not exceed 80 percent of the credit base of such property, and

(III) such financing is borrowed from a qualified person or represents a loan from any

Federal, State, or local government or instrumentality thereof, or is guaranteed by any Federal, State, or local government.

Such term shall not include any convertible debt.

(iii) Nonrecourse Financing.—For purposes of this subparagraph, the term "nonrecourse financing" includes—

(I) any amount with respect to which the taxpayer is protected against loss through guarantees, stop-loss agreements, or other similar arrangements, and—

(II) except to the extent provided in regulations, any amount borrowed from a person who has an interest (other than as a creditor) in the activity in which the property is used or from a related person to a person (other than the taxpayer) having such an interest.

In the case of amounts borrowed by a corporation from a shareholder, subclause (II) shall not apply to an interest as a shareholder.

(iv) Qualified Person.—For purposes of this paragraph, the term "qualified person" means any person which is actively and regularly engaged in the business of lending money and which is not—

(I) a related person with respect to the taxpayer,

(II) a person from which the taxpayer acquired the property (or a related person to such person), or

(III) a person who receives a fee with respect to the taxpayer's investment in the property (or a related person to such person).

(v) Related Person.—For purposes of clause (i), the term "related person" has the meaning given such term by section 168(e)(4). Except as otherwise provided in regulations prescribed by the Secretary, the determination of whether a person is a related person shall be made as of the close of the taxable year in which the property is placed in service.

(E) Application to Partnerships and S Corporations.—For purposes of this paragraph and paragraph (9)—

(i) In General.—Except as otherwise provided in this subparagraph, in the case of any partnership or S corporation, the determination of whether a partner's or shareholder's allocable share of any financing is nonqualified nonrecourse financing shall be made at the partner or shareholder level.

(ii) Special Rule for Certain Recourse Financing of S Corporation.—A shareholder of an S corporation shall be treated as liable for his allocable share of any financing provided by a

qualified person to such corporation if-

(I) such financing is recourse financing (determined at the corporate level), and

(II) such financing is provided with respect to qualified business property of such corporation.

(iii) Qualified Business Property. —For purposes of clause (ii), the term "qualified business property" means any property if-

(I) such property is used by the corporation in the active conduct of a trade or business,

(II) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 3 full-time employees who were not owner-employees (as defined in section 465(c)(7)(i)) and substantially all the services of whom were services directly related to such trade or business, and

(III) during the entire 12-month period ending on the last day of such taxable year, such corporation had at least 1 full-time employee substantially all of the services of whom were in the active management of the trade or business.

Such term shall not include any master sound recording or other tangible or intangible asset associated with literary, artistic, or musical properties.

(iv) Determination of Allocable Share.—The determination of any partner's or shareholder's allocable share of any financing shall be made in the same manner as the credit allowable by section 38 with respect to such property.

(F) Special rule for certain energy property.—

(i) In General.—Subparagraph (A) shall not apply with respect to qualified energy property.

(ii) Qualified Energy Property.—The term "qualified energy property" means energy property to which (but for this subparagraph) subparagraph (A) applies and-

(I) which is described in clause (iii),

(II) with respect to which the energy percentage determined under subsection (b)(2) at the time such property is placed in service is greater than zero,

(III) as of the close of the taxable year in which the property is placed in service, not more than 75 percent of the basis of such property is attributable to nonqualified nonrecourse financing, and

(IV) with respect to which any nonqualified nonrecourse financing in connection with such property consists of a level payment loan.

For purposes of subclause (II), the energy percentage for property described in clause (iii)(V) shall be treated as being greater than zero during any period the energy percentage for property described in section 48(*l*)(14) is greater than zero.

(iii) Property to Which This Subparagraph Applies.—Energy property is described in this clause if such property is-

(I) described in clause (ii), (iv), or (vii) or section 48(*l*) (2),

(II) described in section 48(*l*)(15),

(III) described in section 48(*l*)(3)(A)(iii) (but only to the extent such property is used for converting an alternate substance into alcohol for fuel purposes),

(IV) described in clause (i) of section 48(*l*)(2)(A) (but only to the extent such property is also described in section 48(*l*)(3)(A)(viii) or (ix)), or

(V) property comprising a system for using the same energy source for the sequential generation of electrical power, mechanical shaft power, or both, in combination with

steam, heat, or other forms of useful energy.

(iv) Level Payment Loan Defined.—The term "level payment loan" means a loan in which each installment is substantially equal, a portion of each installment is attributable to the repayment of principal, and that portion is increased commensurate with decreases in the portion of the payment attributable to interest.

(9) Subsequent decreases in nonqualified nonrecourse financing with respect to the property.—

(A) In General.—If, at the close of a taxable year following the taxable year in which the property was placed in service, there is a net decrease in the amount of nonqualified nonrecourse financing with respect to such property, such net decrease shall be taken into account as additional qualified investment in such property in accordance with subparagraph (C).

(B) Certain Transactions Not Taken Into Account.—For purposes of this paragraph, nonqualified nonrecourse financing shall not be treated as decreased through the surrender or other use of property financed by nonqualified nonrecourse financing.

(C) Manner in which taken into account.—

(i) Credit Determined by Reference to Taxable Year Property Placed in Service.—For purposes of

determining the amount of credit allowable under section 38 and the amount of credit subject to the early disposition or cessation rules under section 47, any increase in a taxpayer's qualified investment in property by reason of this paragraph shall be deemed to be additional qualified investment made by the taxpayer in the year in which the property referred to in subparagraph (A) was first placed in service.

(ii) Credit Allowed for Year of Decrease in Nonqualified Nonrecourse Financing.—Any credit allowable under this subpart for any increase in qualified investment by reason of this paragraph shall be treated as earned during the taxable year of the decrease in the amount of nonqualified nonrecourse financing.

(h) Qualified progress expenditures.—

(1) Increase in qualified investment.—

(A) In General.—In the case of any taxpayer who has made an election under paragraph (6), the amount of the qualified investment of such taxpayer for the taxable year (determined under subsection (c) without regard to this subsection) shall be increased by an amount equal to the 'aggregate of the applicable percentage of each qualified progress expenditure for the taxable year with respect to progress expenditure property.

(B) Applicable percentage.—

(i) Recovery Property.—For purposes of subparagraph (A), the applicable percentage for recovery property (within the meaning of section 168) shall be determined under sub section (c)(7) based on a reasonable expectation of what the character of the property will be when it is placed in service.

(ii) Nonrecovery Property.—For purposes of subparagraph (A), the applicable percentage for property which is not recovery property (within the meaning of section 168) shall be determined under subsection (c)(2) based on a reasonable expectation of what the useful life of the property will be when it is placed in service.

(iii) Application on Basis of Facts Known.—Clauses (i) and (ii) shall be applied on the basis of the facts known at the close of the taxable year of the taxpayer in which the expenditure is made.

(2) Progress expenditure property defined.—

(A) In General.—For purposes of this subsection, the term "progress expenditure property" means any property which is being constructed by or for the taxpayer and which-

(i) has a normal construction period of two years or more, and

(ii) it is reasonable to believe will be new section 38 property in the hands

of the taxpayer when it is placed in service.

Clauses (i) and (ii) of the preceding sentence shall be applied on the basis of facts known at the close of the taxable year of the taxpayer in which construction begins (or, if later, at the close of the first taxable year to which an election under this subsection applies).

(B) Normal Construction Period.—For purposes of subparagraph (A), the term "normal construction period" means the period reasonably expected to be required for the construction of the property—

(i) beginning with the date on which physical work on the construction begins (or, if later, the first day of the first taxable year to which an election under this subsection applies), and

(ii) ending on the date on which it is expected that the property will be available for placing in service.

(3) Qualified progress expenditures defined. -For purposes of this subsection—

(A) Self-Constructed Property.—In the case of any self-constructed property, the term "qualified progress expenditures" means the amount which, for purposes of this subpart, is, properly chargeable (during such taxable year) to capital account with respect to such property.

(B) Non-Self-Constructed Property.—In the case of non-self-constructed property, the term "qualified progress expenditures" means the lesser of—

(i) the amount paid during the taxable year to another person for the construction of such property, or

(ii) the amount which represents that proportion of the overall cost to the taxpayer of the construction by such other person which is properly attributable to that portion of such construction which is completed during such taxable year.

(4) Special Rules for Applying Paragraph (3).—For purposes of paragraph (3)—

(A) Component Parts, Etc.—Property which is to be a component part of, or is otherwise to be included in, any progress expenditure property shall be taken into account-

(i) at a time not earlier than the time at which it becomes irrevocably devoted to use in the progress expenditure property, and

(ii) as if (at the time referred to in clause (i)) the taxpayer had expended an amount equal to that portion of the cost to the taxpayer of such component or other property which, for purposes of this subpart, is properly chargeable (during such taxable year) to capital account with respect to such property.

(B) Certain Borrowings Disregarded.—Any amount borrowed directly or indirectly by the taxpayer from the person constructing the property for him shall not be treated as

an amount expended for such construction.

(C) Certain Unused Expenditures Carried Over.—In the case of non-self-constructed property, if for the taxable year—

(i) the amount under clause (i) of paragraph (3)(B) exceeds the amount under clause (ii) of paragraph (3)(B), then the amount of such excess shall be taken into account under such clause (i) for the succeeding taxable year, or

(ii) the amount under clause (ii) of paragraph (3)(B) exceeds the amount under clause (i) of paragraph (3)(B), then the amount of such excess shall be taken into account under such clause (ii) for the succeeding taxable year.

(D) Determination of Percentage of Completion.—In the case of non-self-constructed property, the determination under paragraph (3)(B)(ii) of the proportion of the overall cost to the taxpayer of the construction of any property which is properly attributable to construction completed during any taxable year shall be made, under regulations prescribed by the Secretary, on the basis of engineering or architectural estimates or on the basis of cost accounting records. Unless the taxpayer establishes otherwise by clear and convincing evidence, the construction shall be deemed to be completed not more

rapidly than ratably over the normal construction period.

(E) No Qualified Progress Expenditures for Certain Prior Periods.—In the case of any property, no qualified progress expenditures shall be taken into account under this subsection for any period before January 22, 1975 (or, if later, before the first day of the first taxable year to which an election under this subsection applies).

(F) No qualified progress expenditures for property for year it is placed in service, etc. -In the case of any property, no qualified progress expenditures shall be taken into account under this subsection for the earlier of—

(i) the taxable year in which the property is placed in service, or

(ii) the first taxable year for which recapture is required under section 47(a)(3) with respect to such property, or for any taxable year thereafter.

(5) Other Definitions.—For purposes of this subsection—

(A) Self-Constructed Property.—The term "self-constructed property" means property more than half of the construction expenditures for which it is reasonable to believe will be made directly by the taxpayer.

(B) Non-Self-Constructed Property.—The term "non-self-constructed property"

means property which is not self-constructed property.

(C) Construction, Etc.—The term "construction" includes reconstruction and erection, and the term "constructed" includes reconstructed and erected.

(D) Only Construction of Section 38 Property to be Taken Into Account.—Construction shall be taken into account only if, for purposes of this subpart, expenditures therefor are properly chargeable to capital account with respect to the property.

(6) Election.—An election under this subsection may be made at such time and in such manner as the Secretary may by regulations prescribe. Such an election shall apply to the taxable year for which made and to all subsequent taxable years. Such an election, once made, may not be revoked except with the consent of the Secretary.

(7) Transitional Rules.—The qualified investment taken into account under this subsection for any taxable year beginning before January 1, 1980, with respect to any property shall be (in lieu of the full amount) an amount equal to the sum of—

(A) the applicable percentage of the full amount determined under the following table:

For a taxable year beginning in::	The applicable percentage is:
1974 or 1975	20
1976	40
1977	60

1978 80

1979 .....100;

plus

(B) in the case of any property to which this subsection applied for one or more preceding taxable years, 20 percent of the full amount for each such preceding taxable year.

For purposes of this paragraph, the term "full amount", when used with respect to any property for any taxable year, means the amount of the qualified investment for such property for such year determined under this subsection without regard to this paragraph.

(i) Limitations with respect to certain persons.—

(1) In General.—In the case of—

(A) an organization to which section 593 applies, and

(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (sec. 851 and following), the qualified investment shall equal such person's ratable share of such qualified investment.

(2) Ratable Share.—For purposes of paragraph (I), the ratable share of any person for any taxable year of qualified investment shall be—

(A) in the case of an organization referred to in paragraph (l)(A), 50 percent thereof, and

(B) in the case of a regulated investment company or a real estate investment trust, the ratio (i) the numerator of which is its taxable income and (ii) the denominator

of which is its taxable income computed without regard to the deduction for dividends paid provided by section 852(b)(2)(D) or 857(b)(2) (B), as the case may be.

For purposes of subparagraph (B) of the preceding sentence, the term "taxable income" means in the case of a regulated investment company its investment company taxable income (within the meaning of section 852(b)(2)), and in the case of a real estate investment trust its real estate investment trust taxable income (within the meaning of section 857@)(2)) determined without regard to any deduction for capital gains dividends (as defined in section 857(b)(3)(C)) and by excluding any net capital gain.

(3) Noncorporate Lessors.—A credit shall be allowed by section 38 to a person which is not a corporation with respect to property of which such person is the lessor only if—

(A) the property subject to the lease has been manufactured or produced by the lessor, or

(B) the term of the lease (taking into account options to renew) is less than 50 percent of the useful life of the property, and for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property.

In the case of property of which a partnership is the lessor, the credit otherwise allowable under section 38 with respect to such property to any partner which is a corporation shall be allowed notwithstanding the first sentence of this paragraph. For purposes of this paragraph, an S corporation shall be treated as a person which is not a corporation. This paragraph shall not apply with respect to any property which is treated as section 38 property by reason of section 48(a)(l)(E). For purposes of subparagraph (B), in the case of any recovery property (within the meaning of section 168), the useful life shall be the present class life for such property (as defined in section 168(g)(2)).

(4) Special rules where section 593 organization is lessee.—

(A) In general.—For purposes of paragraph (l)(A), if an organization described in section 593 is the lessee of any section 38 property, the lessor of such property shall be treated as an organization described in section 593 with respect to such property.

(B) Exception for short-term leases.—This paragraph shall not apply to any property by reason of use under a lease with a term of less than 6 months (determined under section 1680')(6)).

(C) Election not to have subparagraph (A) apply.—Subparagraph (A) shall not apply for any taxable year to an organization described in section 593 if such organization elects to compute for such year and all subsequent taxable years the amount of the deduction for a reasonable addition to a reserve for bad debts on the basis of actual experience. Any such election shall apply to any successor

organization engaged in substantially similar activities and, once made, shall be irrevocable.

(j) Limitation in case of certain regulated companies.—

(1) General rule.—Except as otherwise provided in this subsection, no credit determined under subsection (a) shall be allowed by section 38 with respect to any property described in section 50 (as in effect before its repeal by the Revenue Act of 1978) which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) Cost of service reduction.—If the taxpayer's cost of service for ratemaking purposes is reduced by reason of any portion of the credit determined under subsection (a) and allowable by section 38 (determined without regard to this subsection); or

(B) Rate base reduction.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit determined under subsection (a) and allowable by section 38 (determined without regard to this subsection).

Subparagraph (B) shall not apply if the reduction in the rate base is restored not less rapidly than ratably. If the taxpayer makes an election under this sentence within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, the immediately preceding sentence shall not apply to property described in paragraph (5)(B) if any agency or instrumentality of the United States having jurisdiction for ratemaking purposes with respect to such taxpayer's trade or

business referred to in paragraph (5)(B) determines that the natural domestic supply of the product furnished by the taxpayer in the course of such trade or business is insufficient to meet the present and future requirements of the domestic economy.

(2) Special rule for ratable flow-through.—If the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraph (1) shall not apply, but no credit determined under subsection (a) shall be allowed by section 38 with respect to any property described in section 50 (as in effect before its repeal by the Revenue Act of 1978) which is public utility property (as defined in paragraph (5)) of the taxpayer-

(A) Cost of service reduction.—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit determined under subsection (a) and allowable by section 38 (determined without regard to this subsection), or

(B) Rate base reduction.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit determined under subsection (a) and allowable by section 38 (determined without regard to this subsection).

(3) Special rule for immediate flow-through in certain cases.—In the case of property to which section 167(1)(2)(C) applies, if the taxpayer makes an election under this

paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraphs (1) and (2) shall not apply to such property.

(4) Limitation.—

(A) In general.—The requirements of paragraphs (I), (2), and (9) regarding cost of service and rate base adjustments shall not be applied to public utility property of the taxpayer to disallow the credit with respect to such property before the first final determination which is inconsistent with paragraph (I), (2), or (9) (as the case may be) is put into effect with respect to public utility property (to which this subsection applies) of the taxpayer. Thereupon, paragraph (I), (2), or (9) shall apply to disallow the credit with respect to public utility property (to which this subsection applies) placed in service by the taxpayer—

(i) before the date that the first final determination, or a subsequent determination, which is inconsistent with paragraph (i), (2), or (9) (as the case may be) is put into effect, and

(ii) on or after the date that a determination referred to in clause (i) is put into effect and before the date that a subsequent determination thereafter which is consistent with paragraph (I), (2), or (9) (as the case may be) is put into effect.

(B) Determinations.—For purposes of this paragraph, a determination is a determination made with respect to public

utility property (to which this subsection applies) by a governmental unit, agency, instrumentality, or commission or similar body described in subsection (c)(3)(B) which determines the effect of the credit determined under subsection (a) and allowed by section 38 (determined without regard to this subsection.

(i) on the taxpayer's cost of service or rate base for ratemaking purposes, or

(ii) in the case of a taxpayer which made an election under paragraph (2) or the election described in paragraph (9), on the taxpayer's cost of service for ratemaking purposes or in its regulated books of account or rate base for ratemaking purposes.

(C) Special rules.—For purposes of this paragraph—

(i) a determination is final if all rights to appeal or to request a review, a rehearing, or a redetermination, have been exhausted or have lapsed,

(ii) the first final determination is the first final determination made after the date of the enactment of this subsection, and

(iii) a subsequent determination is a determination subsequent to a final determination.

(5) Public utility property.—For purposes of this subsection, the term "public utility property" means—

(A) property which is public utility property within the meaning of subsection (c)(3)(B), and

(B) property used predominantly in the trade or business of the furnishing or sale of (i) steam through a local distribution system or (ii) the transportation of gas or steam by pipeline, if the rates for such furnishing or sale are established or approved by a governmental unit, agency, instrumentality, or commission described in subsection (c)(3)(B).

(6) Ratable portion.—For purposes of determining ratable restorations to base under paragraph (1) and for purposes of determining ratable portions under paragraph (2)(A), the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account shall be used.

(7) Reorganizations, assets acquisitions, etc.—If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

(8) Prohibition of immediate flowthrough.—An election made under paragraph (3) shall apply only to the amount of the credit determined

under subsection (a) and allowable under section 38 with respect to public utility property (within the meaning of the first sentence of subsection (c)(3)(B)) determined as if the Tax Reduction Act of 1975, the Tax Reform Act of 1976, the Energy Tax Act of 1978, and the Revenue Act of 1978 had not been enacted. Any taxpayer who had timely made an election under paragraph (3) may, at his own option and without regard to any requirement imposed by an agency described in subsection (c)(3)(B), elect within 90 days after the date of the enactment of the Tax Reduction Act of 1975 (in such manner as the Secretary shall prescribe) to have the provisions of paragraph (3) apply with respect to the amount of the credit determined under subsection (a) and allowable under section 38 with respect to such property which is in excess of the amount determined under the preceding sentence. If such taxpayer does not make such an election, paragraph (1) or (2) (whichever paragraph is applicable without regard to this paragraph) shall apply to such excess credit, except that if neither paragraph (1) nor (2) is applicable (without regard to this paragraph), paragraph (1) shall apply unless the taxpayer elects (in such manner as the Secretary shall prescribe) within 90 days after the date of the enactment of the Tax Reduction Act of 1975 to have the provisions of paragraph (2) apply. The provisions of this paragraph shall not be applied to disallow such excess credit before the first final determination which is inconsistent with such requirements is made, determined in the same manner as under paragraph (4).

(9) Special rule for additional credit.—If the taxpayer makes an election under subparagraph (E) of subsection (a)(2), for a taxable year beginning after December 31, 1975, then, notwithstanding the prior paragraphs of this subsection, no credit shall be allowed by section 38 in excess of the amount which would be allowed without regard to the provisions of subparagraph (E) of subsection (a)(2) if—

(A) the taxpayer's cost of service for rate making purposes or in its regulated books of account is reduced by reason of any portion of such credit which results from the transfer of employer securities or cash to a tax credit employee stuck ownership plan which meets the requirements of section 409A;

(B) the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan; or

(C) any portion of the amount of such credit which results from a transfer described in sub paragraph (A) to such employee stock ownership plan is treated for ratemaking purposes in any way other than as though it had been contributed by the taxpayer's common share holders.

(10) Use of inconsistent estimates and projections etc., for purposes of paragraphs (1) and (2).—

(A) In general.—One way in which the requirements of paragraph (1) or (2) are not met is if the taxpayer, for ratemaking

purposes, uses a procedure or adjustment which is inconsistent with the requirements of paragraph (1) or paragraph (2), as the case may be.

(B) Use of inconsistent estimates and projections.—The procedures and adjustments which are to be treated as inconsistent for purposes of subparagraph (A) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's qualified investment for purposes of the credit allowable by section 38 unless such estimate or projection is consistent with the estimates and projections of property which are used, for ratemaking purposes, with respect to the taxpayer's depreciation expense and rate base.

(C) Regulatory authority.—The Secretary may by regulations prescribe procedures and adjustments in addition to those specified in subparagraph (B)) which are to be treated as inconsistent for purposes of subparagraph (A).

(k) 50 Percent Credit in the Case of Certain Vessels.—

(1) In general.—In the case of a qualified withdrawal out of the untaxed portion of a capital gain account or out of an ordinary income account in a capital construction fund established under section 607 of the Merchant Marine Act, 1936 (46 U.S.C. 1177), for—

(A) the acquisition, construction, or reconstruction of a qualified vessel, or

(B) the acquisition, construction, or reconstruction of barges or containers

which are part of the complement of a qualified vessel and to which subsection (f)(1)(B) of such section 607 applies,

for purposes of section 38 there shall be deemed to have been made (at the time of such withdrawal) a qualified investment (within the meaning of subsection (c)) or qualified progress expenditures (within the meaning of subsection (d)), whichever is appropriate, with respect to property which is section 38 property.

(2) Amount of credit.—For purposes of paragraph (1), the amount of the qualified investment shall be 50% of the applicable percentage of the qualified withdrawal referred to in paragraph (1), or the amount of the qualified progress expenditures shall be 50 percent of such withdrawal, as the case may be. For purposes of determining the amount of the credit allowable by reason of this subsection for any taxable year, the limitation of section 38(c) shall be determined without regard to subsection (d)(1)(A) of such section 607.

(3) Coordination with section 38.—The amount of the credit allowable by reason of this subsection with respect to any property shall be the minimum amount allowable under section 38 with respect to such property. If, without regard to this subsection, a greater amount is allowable under section 38 with respect to such property, then such greater amount and this subsection shall not apply.

(4) Coordination with section 47.—Section 47 shall be applied—

(A) to any property to which this subsection applies, and

(B) to the payment (out of the untaxed portion of a capital gain account or out of the ordinary income account of a capital construction fund established under

section 607 of the Merchant Marine Act, 1936) of the principal of any indebtedness incurred in connection with property with respect to which a credit was allowed under section 38.

For purposes of section 47, any payment described in subparagraph (B) of the preceding sentence shall be treated as a disposition occurring less than 3 years after the property was placed in service; but, in the case of a credit allowable without regard to this subsection, the aggregate amount which may be recaptured by reason of this sentence shall not exceed 50 percent of such credit.

(5) Definitions.-Any term used in section 607 of the Merchant Marine Act, 1936, shall have the same meaning when used in this subsection.

(6) No inference.-Nothing in this subsection shall be construed to infer that any property described in this subsection is or is not section 38 property, and any determination of such issue shall be made as if this subsection had not been enacted.

(l) Special Rules for Cooperatives.-In the Case of a Organization Described in Section 1381(a)

(1) that portion of the credit determined under subsection (a) and allowable to the organization under section 38 which the organization cannot use for the taxable year to which the qualified investment is attributable because of the limitation contained in section 38(c) shall be allocated to the patrons of the organization,

(2) section 47 (relating to certain dispositions, etc., of section 38 property) shall be applied as if any allocated portion of the credit had been retained by the organization, and

(3) the rules necessary to carry out the purposes of this subsection shall be determined under regulations prescribed by the Secretary.

APPENDIX G

26 U.S.C. §47

§ 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38 PROPERTY

(m) General Rule.—Under regulations prescribed by the Secretary-

(1) Early disposition, etc.—If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

(2) Property becomes public utility property.—If during any taxable year any property taken into account in determining qualified investment becomes public utility property (within the meaning of section 46(c)(3)(B)), then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted, solely from treating the property, for purposes of determining qualified investment, as public utility property (after

giving due regard to the period before such change in use). If the application of this paragraph to any property is followed by the application of paragraph (1) to such property, proper adjustment shall be made in applying paragraph (1).

(3) Property ceases to be progress expenditure property.—

(A) In general.—If during any taxable year any property taken into account in determining qualified investment under section 46(d) ceases (by reason of sale or other disposition, cancellation or abandonment of contract, or otherwise) to be, with respect to the taxpayer, property which, when placed in service, will be new section 38 property, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from reducing to zero the qualified investment taken into account with respect to such property.

(B) Certain excess credit recaptured.—Any amount which would have been applied as a reduction of the qualified investment in property by reason of paragraph (4) of section 46(c) but for the fact that a reduction under such paragraph cannot reduce qualified investment below zero shall be treated as an amount required to be recaptured under subparagraph (A) for the taxable year in which the property is placed in service.

(C) Certain sales and leasebacks.—Under regulations prescribed by the Secretary, a sale by, and leaseback to, a taxpayer who, when the property is placed in service, will be a lessee to whom section 48(d) applies shall not be treated as a cessation described in subparagraph (A) to the extent that the qualified investment which will be passed through to. the lessee under section 48(d) with respect to such property is not less than the qualified progress expenditures properly taken into account by the lessee with respect to such property.

(D) Coordination with paragraphs (1) and (5).—If, after property is placed in service, there is a disposition or other cessation described in paragraph (1), or a disposition, cessation, or change in expected use described in paragraph (5), then paragraph (1) or (5), as the case may be, shall be applied as if any credit, which was allowable by reason of section 46(d) and which has not been required to be recaptured before such disposition, cessation, or change in use were allowable for the taxable year the property was placed in service.

(4) Special rules for commuter highway vehicles.—

(A) Useful life.—For purposes of this subsection, 3 years shall be treated as the useful life which was taken into account in computing the credit under section 38 with respect to any commuter highway vehicle (as defined in section 46(c)(6)(B)).

(B) Change in use.—If less than 80 percent of the mileage use of any commuter highway vehicle by the taxpayer during that portion of any taxable year which is within the first 36 months of the operation of such vehicle by the taxpayer meets the requirements of section 46(c)(6)(B), then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from treating such vehicle, for purposes of determining qualified investment, as not being a commuter highway vehicle. If the application of this subparagraph to any property is followed by the application of paragraph (1) to such property, proper adjustment shall be made in applying paragraph (1).

(5) Special rules for recovery property.—

(A) General rule.—If, during any taxable year, section 38 recovery property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer before the close of the recapture period, then, except as provided in subparagraph (D), the tax under this chapter for such taxable year shall be increased by the recapture percentage of the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from reducing to zero the qualified investment taken into account with respect to such property.

(B) Recapture percentage.—For purposes of subparagraph (A), the recapture percentage shall be determined in accordance with the following table:

If the recovery property ceases to be section 38 property within—	The recapture percentage is: For property other than 3-year property	The recapture percentage is: For 3-year property
One full year after placed in service	100	100
One full year after the close of the period described in clause (i).....	80	66
One full year after the close of the period described in clause (ii).....	60	33
One full year after the close of the period described in clause (iii)	40	0
One full year after the close of the period described in clause (iv).....	20	0

(C) Property ceases to be progress expenditure property.—If, during any taxable year, any recovery property taken into account in determining qualified investment under section 46(d)(l) ceases to be progress expenditure property (as determined under paragraph (3)) or becomes, with respect to the taxpayer, recovery property of a character other

than that expected in determining the applicable percentage under section 46(d)(l)(B)(i), then the tax under this chapter for such taxable year shall be adjusted in accordance with regulations prescribed by the Secretary.

(D) Limitation.—The tax for the taxable year shall be increased under subparagraph (A) only with respect to the credits allowed under section 38 which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carrybacks and carryovers under section 39 shall be appropriately adjusted. If, prior to a disposition to which this subsection applies, any portion of any credit is not allowable with respect to any property by reason of section 168(i)(3), such portion shall be treated (for purposes of this subparagraph) as not having been used to reduce tax liability.

(E) Definitions and special rules.—

(i) Section 38 recovery property.—For purposes of this paragraph, the term "section 38 recovery property" means any section 38 property which is recovery property (within the meaning of section 168).

(ii) Recapture period.—For purposes of this paragraph, the term "recapture period" means, with respect to any recovery property, the period consisting of the first full year after the property is placed in service and the 4 succeeding full years (the 2

succeeding full years in the case of 3-year property).

(iii) Classification of property.—For purposes of this paragraph, property shall be classified as provided in section 168(c).

(iv) Paragraph (1) not to apply.—Paragraph (1) shall not apply with respect to any recovery property.

(6) Carrybacks and carryovers adjusted.—In the case of any cessation described in paragraph (1), (3), or (5) or any change in use described in paragraph (2) or (4), the carrybacks and carryovers under section 39 shall be adjusted by reason of such cessation (or change in use).

(7) Aircraft used outside the United States after April 18, 1969.—

(A) General rule.—Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used outside the United States under a qualifying lease or leases shall be treated as not ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 3 1/2 years in total. For purposes of the preceding sentence, the registration of such aircraft under the laws of a foreign country shall be treated as use outside the United States.

(B) Computation of qualified investment.—If an aircraft described in subparagraph (A) is disposed of or otherwise ceases to be section 38 property, the increase under paragraph (1) and the adjustment under

paragraph (6) shall not be greater than the increase or adjustment which would result if the qualified investment of such aircraft were based upon a useful life equal to the lesser of (i) the actual useful life of such aircraft with respect to the taxpayer, or, (ii) twice the number of full calendar months during which such aircraft was registered by the Administrator of the Federal Aviation Agency and was used in the United States, operated to and from the United States, or operated under contract with the United States. For purposes of the preceding sentence, an aircraft shall be treated as used in the United States for any calendar month beginning after such aircraft was placed in service, if such month is included in a taxable year ending before January 1, 1971, for which such aircraft was section 38 property (determined without regard to this paragraph).

(C) Qualifying lease defined.—For purposes of subparagraph (A), the term "qualifying lease" means a lease from an air carrier (as defined in section 101 of the Federal Aviation Act of 1958, as amended (49 U.S.C. 1301)) which complies with the provisions of the Federal Aviation Act of 1958, as amended, and the rules and regulations promulgated by the Secretary of Transportation thereunder, but only if such lease was executed after April 18, 1969.

(8) Motion picture films and video tapes.—

(A) Disposition where depreciation exceeds 90 percent of basis or cost. A qualified

film (within the meaning of section 48(k)(l)(B)) which has an applicable percentage determined under section 48(k)(3) shall cease to be section 38 property with respect to the taxpayer at the close of the first day op which the aggregate amount allowable as a deduction under section 167 equals or exceeds 90 percent of the basis or cost of such film (adjusted for any partial dispositions).

(B) Other dispositions.—In the case of a disposition of the exclusive right to display a qualified film which has an applicable percentage determined under section 48(k)(3) in one or more mediums of publication or exhibition in one or more specifically defined geographical areas over the remaining initial period of commercial exploitation of the film or tape in such geographical areas, the taxpayer shall be considered to have disposed of all or part of such film or tape and shall recompute the credit earned on all of his basis or cost or on that part of the basis or cost properly allocable to that part of the film or tape disposed of. In the case of an affiliated group of corporations, a transfer within the affiliated group shall not be treated as a disposition until there is a transfer outside the group. For purposes of the preceding sentence, the term "affiliated group" has the meaning given to such term by section 1504 (determined as if section 1504(b) did not include paragraph (3) thereof). For purposes of this paragraph, section 1504(a) shall be applied by substituting

"50 percent" for "80 percent" each place it appears.

(n) Section Not to Apply in Certain Cases.—Subsection (a) shall not apply to—

(1) a transfer by reason of death,

(2) a transaction to which section 381(a) applies, or

(3) a transfer to which subsection (c) of section 374 (relating to exchanges under the final system plan for ConRail) applies.

For purposes of subsection (a), property shall not be treated as ceasing to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as section 38 property and the taxpayer retains a substantial interest in such trade or business.

(o) Special Rule.—Any increase in tax under subsection (a) shall not be treated as tax imposed by this chapter for purposes of determining the amount of any credit allowable under subpart A, B, or D.

(p) Increases in Nonqualifled Nonrecourse Financing.—

(1) In general.—If, as of the close of the taxable year, there is a net increase with respect to the taxpayer in the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)) with respect to any property to which section 46(c)(8) applied, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in credits allowed under section 38 for all prior taxable years which would have resulted from reducing the qualified investment taken into account with

respect to such property by the amount of such net increase.

(2) Transfers of debt more than 1 year after initial borrowing not treated as increasing nonqualified nonrecourse financing.—For purposes of paragraph (1), the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)(D)) with respect to the taxpayer shall not be treated as increased by reason of a transfer of (or agreement to transfer) any evidence of an indebtedness if such transfer occurs (or such agreement is entered into) more than 1 year after the date such indebtedness was incurred.

(3) Special rules for certain energy property.—

(A) In general.—In the case of the second taxable year following the taxable year in which any qualified energy property (within the meaning of section 46(c)(8)(F)) is placed in service by the taxpayer and any succeeding taxable year, the taxpayer, for purposes of paragraph (1), shall be treated as increasing the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)) with respect to such property for such taxable year in an amount equal to the credit recapture amount (if any).

(B) Credit recapture amount.—For purposes of this paragraph, the term "credit recapture amount" means an amount equal to the excess (if any) of—

(i) the total amount of principal to be paid as of the close of any taxable year under a nonrecourse level payment loan (as defined in section

46(c)(8)(F)(iv)) with respect to such property, over

(ii) the sum of—

(I) the amount of principal actually paid as of the close of such taxable year, plus

(II) the sum of the credit recapture amounts with respect to such property for all preceding taxable years.

(C) Special rules for determining principal to be paid.—For purposes of subparagraph (B)(i), in determining the amount of the principal to be paid under a level payment loan, such determination shall be made as if such loan was to be fully repaid by the end of a period equal to the earlier of—

(i) the present class life (as defined in section 168(g)(2)) of the property or, if the property has no present class life, a similar period determined by the Secretary, or

(ii) the period at the end of which full repayment is to occur under the terms of the loan.

(D) Special rule for certain cumulative deficiencies.—If the excess of—

(i) the amount of the total scheduled principal payments under a loan described in subparagraph (B)(i) as of the close of the taxable year, over

(ii) the total principal actually paid under such loan as of the close of such taxable year,

is equal to or greater than the amount of such total scheduled payments for the taxable year period ending with such taxable year, then, notwithstanding subparagraph (B), the credit recapture amount for such taxable year shall be equal to the principal remaining to be paid as of the close of such taxable year over the sum of the credit recapture amounts with respect to such property for all preceding taxable years.

(E) Special rule for certain dispositions.—

(i) In general.—If any property which is held by the taxpayer and to which this paragraph applies is disposed of by the taxpayer, then for purposes of paragraph (1) and notwithstanding subparagraph (B), the credit recapture amount for the taxpayer shall be an amount equal to the unpaid principal on the loan described in subparagraph (B)(i) as of the date of disposition;

(ii) Assumptions, etc.—Any amount of the loan described in subparagraph (B)(i) which is assumed or taken subject to by any person shall be treated for purposes of clause (i) as not reducing unpaid principal with respect to such loan.

(F) Application with subsection (a).—The amount of any increase in tax under subsection (a) with respect to any property to which this paragraph applies shall be determined by reducing the qualified investment with respect to such property by the aggregate credit recapture amounts for all taxable years under this paragraph.

(G) Additional interest.—In the case of any increase in tax under paragraph (1) by reason of the application of this paragraph, there shall be added to such tax interest on such tax (determined under section 6621) as if the increase in tax under paragraph (1) was for the taxable year in which the property was placed in service.

(q) Transfers Between Spouses or Incident to Divorce.—In the case of any transfer described in subsection (a) of section 1041—

(1) subsection (a) of this section shall not apply, and

(2) the same tax treatment under this section with respect to the transferred property shall apply to the transferee as would have applied to the transferor.

APPENDIX H

26 U.S.C. §48

§ 48. DEFINITIONS; SPECIAL RULES.

***

(a) Section 38 Property.—

(1) In general.—Except as provided in this subsection, the term "section 38 property" means—

(A) tangible personal property (other than an air conditioning or heating unit), or

(B) other tangible property (not including a building and its structural components) but only if such property—

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constitutes a research facility used in connection with any of the activities referred to in clause (i), or

(iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or

(C) elevators and escalators, but only if—

(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or

(ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date, or

(D) single purpose agricultural or horticultural structures, or

(E) in the case of a qualified rehabilitated building, that portion of the basis which is attributable to qualified rehabilitation expenditures (within the meaning of subsection (g)), or

(F) in the case of qualified timber property (within the meaning of section 194(cM1)), that portion of the basis of such property constituting the amortizable basis acquired during the taxable year (other than that portion of such amortizable basis attributable to property which otherwise qualifies as section 38 proper

(G) the petition for certiorari has been denied, or

(H) the decision of the United States Court of Appeals has been affirmed by the Supreme Court,

then the decision of the Tax Court rendered upon such rehearing shall become final in the same manner as though no prior decision of the Tax Court has been rendered.

(2) Definition of "mandate."—As used in this section, the term "mandate", in case a mandate has been recalled prior to the expiration of 30 days from the date of issuance thereof, means the final mandate.

APPENDIX I

26 U.S.C. §7482

§ 7482. COURTS OF REVIEW.

(a) Jurisdiction.—The United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

(b) Venue.—

(1) In general.—Except as otherwise provided in paragraphs (2) and (3), such decisions may be reviewed by the United States court of appeals for the circuit in which is located—

(A) in the case of a petitioner seeking redetermination of tax liability other than a corporation, the legal residence of the petitioner,

(B) in the case of a corporation seeking redetermination of tax liability, the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in any judicial circuit, then the office to which was made the return of the tax in respect of which the liability arises,

(C) in the case of a person seeking a declaratory decision under section 7476,

the principal place of business, or principal office or agency of the employer,

(D) in the case of an organization seeking a declaratory decision under section 7428, the principal office or agency of the organization, or

(E) in the case of a petition under section 6226 or 6228(a), the principal place of business of the partnership.

If for any reason no subparagraph of the preceding sentence applies, then such decisions may be reviewed by the Court of Appeals for the District of Columbia. For purposes of this paragraph, the legal residence, principal place of business, or principal office or agency referred to herein shall be determined as of the time the petition seeking redetermination of tax liability was filed with the Tax Court or as of the time the petition seeking a declaratory decision under section 7428, 7476, or 7477, or the petition under section 6226 or 6228(a), was filed with the Tax Court.

(2) By agreement.—Notwithstanding the provisions of paragraph (1), such decisions may be reviewed by any United States Court of Appeals which may be designated by the Secretary and the taxpayer by stipulation in writing.

(3) Declaratory judgment actions relating to status of certain governmental obligations.—In the case of any decision of the Tax Court in a proceeding under section 7478, such decision may only be reviewed by the Court of Appeals for the District of Columbia.

(c) Powers.—

(1) To affirm, modify, or reverse.—Upon such review, such courts shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court,

with or without remanding the case for a rehearing, as justice may require.

(2) To make rules.—Rules for review of decisions of the Tax Court shall be those prescribed by the Supreme Court under section 2072 of title 28 of the United States Code.

(3) To require additional security.—Nothing in section 7483 shall be construed as relieving the petitioner from making or filing such undertakings as the court may require as a condition of or in connection with the review.

(4) To impose damages.—The United States Court of Appeals and the Supreme Court shall have power to impose damages in any case where the decision of the Tax Court is affirmed and it appears that the notice of appeal was filed merely for delay.

APPENDIX J

26 C.F.R. §1.1502-3

§301.1.1502-3 Consolidated Tax Credits.

***

(f) *Early dispositions, etc., of section 38 property – (1) Dispositions of section 38 property during and after consolidated return year.* If property is subject to section 47(a)(1) or (2) with respect to a member during a consolidated return year, any increase in tax shall be added to the tax liability of the group under § 1.1502-2 (regardless of whether the property was placed in service in a consolidated or separate return year). Also, if property is subject to section 47(a)(1) or (2) with respect to a corporation during a taxable year for which such corporation files on a separate return basis, any increase in tax shall be added to the tax liability of such corporation (regardless of whether such property was placed in service in a consolidated or separate return year).

(2) *Exception for transfer to another member* – (i) Except as provided in subdivisions (ii) and (iii) of this subparagraph, a transfer of section 38 property from one member of the group to another member of such group during a consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1). If such section 38 property is disposed of, or otherwise ceases to be section 38 property or becomes public utility property with respect to the transferee, before the close of the estimated useful life which was taken into account in computing qualified investment, then section 47(a)(1) or (2) shall apply to the transferee with respect to such property (determined by taking into account the period of use, qualified investment, other dispositions, etc., of the transferor). Any increase in tax due to the application of section 47(a)(1) or (2) shall be added to the tax liability of such transferee (or the tax liability of a

group, if the transferee joins in the filing of a consolidated return).

(ii) Except as provided in subdivision (iii) of this subparagraph, if section 38 property is disposed of during a consolidated return year by one member of the group to another member of such group which is an organization to which section 593 applies or a cooperative organization described in section 1381(a), the tax under chapter 1 of the Code for such consolidated return year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would result solely from treating such property, for purposes of determining qualified investment, as placed in service by such organization to which section 593 applies or such cooperative organization described in section 1381(a), as the case may be, but with due regard to the use of the property before such transfer.

(iii) Section 47(a)(1) shall apply to a transfer of section 38 property by a corporation during a consolidated return year if such corporation is liquidated in a transaction to which section 334(b)(2) applies.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). P, S, and T file a consolidated return for calendar year 1967. In such year S places in service section 38 property having an estimated useful life of more than 8 years. In 1968, P, S, and T file a consolidated return and in such year S sells such property to T. Such sale will not cause section 47(a)(1) to apply.

Example (2). Assume the same facts as in example (1), except that P, S, and T filed separate returns for 1967. The sale from S to T will not cause section 47(a)(1) to apply.

Example (3). Assume the same facts as in example (1), except that P, S, and T continue to file

consolidated returns through 1971 and in such year T disposes of the property to individual A. Section 47(a)(1) will apply to the group and any increase in tax shall be added to the tax liability of the group. For the purposes of determining the actual period of use by T, such period shall include S's period of use.

Example (4). Assume the same facts as in example (3), except that T files a separate return in 1971. Again, the actual periods of use by S and T will be combined in applying section 47. If the disposition results in an increase in tax under section 47(a)(1), such additional tax shall be added to the separate tax liability of T.

Example (5). Assume the same facts as in example (1), except that in 1969, P sells all the stock of T to a third party. Such sale will not cause section 47(a)(1) to apply.

APPENDIX K

Section 47. – Certain Dispositions, etc., of Section 38 Property.

***

Rev. Rul. 82-20

1982-1 CB 6

ISSUE

Is there a disposition under section 47(a)(1) of the Internal Revenue Code when section 38 property is transferred by a member of an affiliated group that files consolidated returns and the transfer is part of a transaction that qualifies as a "split-off" under section 355(a)(1) and 368(a)(1)(D)?

FACTS

P corporation, whose stock is equally owned by *A* and *B*, has been actively engaged in two separate businesses for more than 5 years. *P* also owns 100 percent of the stock of *S* corporation. *S* has also been actively engaged in business for more than 5 years. *P* and *S* both use the accrual method of accounting and file a consolidated federal income tax return on a calendar year basis.

Because of conflicting opinions between *A* and *B* on the expansion and administration of *P*, it was decided that one of the businesses of *P* and the stock of *S* should be transferred to *A*. Under the plan, *P* transferred all the assets of one of the businesses necessary to conduct the trade or business, including section 38 property, to *S* solely in exchange for additional shares in *S* and immediately thereafter distributed all the stock of *S* to *A*. *S* will continue to use the assets in the same trade or business. The transaction qualified under section 355(a)(1) and 368(a)(1)(D) of the Code. *A* surrendered all its stock in *P* as part of the transaction.

LAW AND ANALYSIS

Section 47(a)(1) of the Code provides that if any property is disposed of, or otherwise ceases to be section 38 property with respect to a taxpayer, before the close of the useful life on which the credit under section 38 was computed, federal income tax will be adjusted for the tax year in which the disposition or cessation took place. *See* section 1.47-1(a) of the Income Tax Regulations.

Section 47(b) of the Code provides exceptions to the disposition provisions of section 47(a). If the transaction involves a mere change in the form of conducting the trade or business, the property will not be treated as ceasing to be section 38 property with respect to the taxpayer so long as the property is retained in that trade or business as section 38 property and the taxpayer retains a substantial interest in the trade or business.

Section 1.47-3(f)(1)(i) of the regulations provides that section 1.47-1(a) does not apply to section 38 property that is disposed of or otherwise ceases to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business in which the section 38 property is used, provided the conditions set forth in section 1.47-3(f)(1)(ii) are satisfied.

Section 1.47-3(f)(5)(ii) of the regulations provides that if in any tax year the transferor of section 38 property described in section 1.47-3(f)(1)(i) does not retain, either directly or indirectly, a substantial interest in the trade or business, as defined in section 1.47-3(f)(2), then, under section 1.47-1(a), the property ceases to be section 38 property with respect to the transferor and the taxpayer must make a recapture determination.

Section 1.1502-3(f)(2)(i) of the regulations provides that a transfer of section 38 property from one member of a consolidated group to another member of the group during a

consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1) of the Code.

Rev. Rul. 74-101, 1974-1 C.B. 7, provides that section 47(a)(1) of the Code applies when a corporation engaged in the same business in three states transfers its business activities in two of the states and all related assets, including section 38 property, to two newly formed corporations solely in exchange for all their stock and immediately thereafter transfers the stock to its sole shareholder in a section 368(a)(1)(D) reorganization.

The issue in Rev. Rul. 74-101 is similar to that described here with one exception. In the present case *P* and *S* are members of a consolidated group that files a consolidated return in the year of transfer. Thus, the specific question is whether the fact that a consolidated group is involved in the transfer should result in a different holding from that in Rev. Rul. 74-101.

The transfer of section 38 property between *P* and *S* constitutes a disposition under section 47(a)(1) of the Code. Although section 1.1502-3(f)(2)(i) of the regulations creates an exception for transfers of section 38 property between members of a consolidated group that would otherwise be dispositions under section 47(a)(1), the exception is premised on the assumption that the property is remaining within the consolidated group. When there is no intention at the time of transfer to keep the property within the consolidated group, the transaction should be viewed as a whole and not as separate individual transactions. *Compare Helvering v. Bashford,* 302 U.S. 454 (1938), Ct. D. 1299, 1938-1 C.B. 286, and Rev. Rul. 70-140, 1970-1 C.B. 73.

In the present case, the transfer of the section 38 propety from *P* to *S* is part of a transaction in which *S* is split off from the group. Because the transfer from *P* to *S* is a step in the planned transfer of the property outside the group, section 1.1502-3(f)(2)(i) of the regulations does not apply.

HOLDING

Because the transfer of the section 38 property from *P* to *S* is a step in the planned transfer of the property outside the group, the exception in section 1.1502- 3(f)(2)(i) of the regulations does not apply to this transaction. Therefore, the transfer from *P* to *S* is a disposition under section 47(a)(1) of the Code.

(3)

Supreme Court, U.S.
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No. 03-1449

In the Supreme Court of the United States

AEROQUIP-VICKERS, INC. AND SUBSIDIARIES, FKA TRINOVA CORPORATION AND SUBSIDIARIES,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly applied de novo review to determine whether the Tax Court erred in refusing to give deference to an Internal Revenue Service (IRS) Revenue Ruling interpreting an IRS regulation.

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In the Supreme Court of the United States

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AEROQUIP-VICKERS, INC. AND SUBSIDIARIES, FKA TRINOVA CORPORATION AND SUBSIDIARIES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-40a) is reported at 347 F.3d 173. The opinion of the Tax Court (Pet. App. 42a-67a) is reported at 108 T.C. 68.

JURISDICTION

The judgment of the court of appeals was entered on October 20, 2003. A petition for rehearing was denied on January 21, 2004 (Pet. App. 41a). The petition for a writ of certiorari was filed on April 19, 2004. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under former Section 38 of the Internal Revenue Code, 26 U.S.C. 38 (1982), a taxpayer who acquired certain property for use in its trade or business (Section 38 property) was allowed an investment tax credit (ITC) calculated by reference to the property's useful life. To ensure accurate estimation of a property's useful life, former Section 47(a)(1) required that the taxpayer "recapture" or repay the ITC if the taxpayer disposed of Section 38 property before the end of its estimated useful life. Section 1.1502-3(f)(3) of the Treasury Regulations, promulgated by the Internal Revenue Service (IRS), creates an exception to this rule for transfer of Section 38 property between members of a consolidated group. 26 C.F.R. 1.1502-3(f)(3). Thus, Example 5 of 26 C.F.R. 1.1502-3(f)(3) indicates that no recapture is required if Section 38 property is transferred to a consolidated subsidiary, and the subsidiary's shares are subsequently sold to a third party in a different tax year. In Revenue Ruling 82-20, however, the Commissioner of Internal Revenue determined that ITC recapture is required if there is no intention at the time the transfer occurs to keep the Section 38 property within the consolidated group. See Rev. Rul. 82-20, 1982-1 C.B. 6.

2. In 1986, petitioner Aeroquip-Vickers, Inc. (formerly known as Trinova Corporation) transferred Section 38 property to a wholly-owned subsidiary with which it filed a consolidated tax return. Pet. App. 1a-2a. Immediately thereafter, petitioner distributed the stock of the subsidiary to one of its shareholders, thus causing the subsidiary and the Section 38 property to leave the consolidated group. *Id.* at 2a, 3a-4a. Although the Section 38 property was not at the end of

its useful life, petitioner did not report any recaptured ITC on its tax returns. *Id.* at 2a. Rather, relying on Example 5 of 26 C.F.R. 1.1502-3(f)(3), petitioner claimed that the transfer of Section 38 property occurred within a consolidated group and was not subject to the recapture rule. The Commissioner disagreed and asserted a deficiency against petitioner for its failure to include recaptured ITC in its 1986 consolidated tax return. Pet. App. 2a.

3. Petitioner sought a redetermination of the deficiency in the United States Tax Court, which concluded that petitioner was not required to recapture any ITC. Pet. App. 42a-67a. The Tax Court reasoned that under Example 5 of 26 C.F.R. 1.1502-3(f)(3) "the mere transfer of section 38 assets within a consolidated group does not trigger recapture," and the subsequent "transfer of stock" of the consolidated subsidiary to a third party also "would not trigger the recapture of such credit." Pet. App. 47a, 48a.

The Tax Court rejected the Commissioner's argument that recapture was required under Revenue Ruling 82-20. Pet. App. 48a. In its view, the Revenue Ruling had no force because it was in "conflict" with "Example (5) of the regulations." *Id.* at 52a. The Tax Court acknowledged (*id.* at 53a) that its interpretation of Revenue Ruling 82-20 was inconsistent with decisions of the Second and Ninth Circuits, both of which interpret Revenue Ruling 82-20 as applying when Section 38 property is transferred to a subsidiary with the intent to make a subsequent transfer of the subsidiary to a third party, whereas 26 C.F.R. 1.1502-3(f)(3) applies when the transactions are sufficiently separated in time as to demonstrate the absence of such intent. See *Walt Disney, Inc.* v. *Commissioner*, 4 F.3d 735 (9th Cir. 1993); *Salomon, Inc.* v. *United States*,

976 F.2d 837 (2d Cir. 1992). The Tax Court "disagree[d] with both the result and reasoning of the Courts of Appeals" and asserted that "the fact that the transfer of the assets and the transfer of the stock occurred in the same, rather than different, taxable years does not provide a meaningful basis for distinguishing Rev. Rul. 82-20 * * * from Example (5) of the regulations." Pet. App. 52a.

In addition, the Tax Court concluded that recapture was not required under the "step transaction" doctrine. Under this doctrine, multiple transactions are treated as a single event for tax purposes if the taxpayer devises the transactions as part of a single plan. Pet. App. 53a-54a. The court reasoned that the step transaction doctrine did not apply because each of petitioner's transactions had a legitimate business purpose. *Ibid.*

4. The court of appeals reversed. Pet. App. 1a-40a. The court initially observed that Revenue Ruling 82-20 was not automatically entitled to deference in light of this Court's decisions in *Christensen* v. *Harris County*, 529 U.S. 576, 587 (2000), and *United States* v. *Mead Corp.*, 533 U.S. 218, 226-227 (2001), which held that agency interpretations that "lack the force of law" are entitled to deference "only to the extent that those interpretations have the 'power to persuade.'" Pet. App. 12a, 14a (quoting *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944)). The court of appeals nonetheless concluded that "the underlying rationale of Revenue Ruling 82-20 is valid, 'reflects the agency's longstanding interpretation of its own regulations,' and thus deserves 'substantial judicial deference.'" *Id.* at 15a (quoting *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001)). The court of appeals dismissed the contention that Revenue Ruling 82-20

was inconsistent with Example 5 of 26 C.F.R. 1.1502-3(f)(3), holding that the regulation "involves a situation where the asset transfer occurs in one year and the spin-off takes place in the following year, while Revenue Ruling 82-20 applies to situations where (as in the instant case) the asset transfer is 'immediately' followed by the spin-off." Pet. App. 14a-15a. Finally, the court concluded that the Commissioner properly applied the step transaction doctrine. The court reasoned that "although the individual steps of the transaction had a legitimate business reason, the transaction must be treated as a single unit and judged by its end result," in this case an attempt to avoid liability for ITC recapture. *Id.* at 17a-18a.

Judge Clay dissented. He concluded that the majority had erroneously deferred to the Commissioner (Pet. App. 19a-24a), and that Revenue Ruling 82-20 was "inconsistent with § 1.1502-3(f)(2)(i) because the treasury regulation focuses on making the transferee responsible for the Section 38 property, whereas the Revenue Ruling looks to the 'intent' of the parties in the consolidated group." *Id.* at 32a.

ARGUMENT

Petitioner argues only that the court of appeals erred in failing to defer to the Tax Court and asks this Court to decide whether "the Tax Court is due some level of respect beyond that of a district court" by virtue of its "special expertise * * * in interpreting the tax laws of the United States." Pet. 10, 11. Petitioner, however, failed to advance that argument in the court of appeals. In addition, the court of appeals correctly applied the de novo standard of review, and its decision does not conflict with any decision of this Court or any other

court of appeals. Further review is therefore not warranted.

1. Petitioner failed to argue in the court of appeals that Tax Court decisions should be accorded some special deference. To the contrary, petitioner and the government *agreed* that courts of appeals should review Tax Court decisions on questions of law de novo. See Pet. C.A. Br. 16 ("The Tax Court's findings of fact are thus reviewed for clear error and its application of law is reviewed *de novo*."); Gov't C.A. Br. 26 ("The Tax Court's holding presents a question of law that this court reviews *de novo*."). Petitioner's rehearing petition similarly failed to raise any question about the applicable standard of review. Accordingly, whether a Tax Court decision is entitled to some special deference is not a question preserved for this Court's review. See *Adarand Constructors, Inc.* v. *Mineta*, 534 U.S. 103, 109 (2001); *Zobrest* v. *Catalina Foothills School Dist.*, 509 U.S. 1, 8 (1993); *United States* v. *Lovasco*, 431 U.S. 783, 788 n.7 (1977); *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970).

2. In addition, there is no conflict among the courts of appeals that would warrant this Court's review. With respect to the primary legal issue decided below, the courts of appeals uniformly hold that Revenue Ruling 82-20 is a reasonable interpretation of the relevant statute and regulations that applies when the initial transfer within the consolidated group is made with the intention of subsequently transferring the property outside the consolidated group. See Pet. App. 14a-15a; *Salomon Inc.* v. *United States*, 976 F.2d 837, 841 (2d Cir. 1992) (holding that Revenue Ruling 82-20 is not "unreasonable, nor inconsistent with prevailing law"); *Walt Disney* v. *Commissioner*, 4 F.3d 735, 741 (9th Cir. 1993) (holding that "Revenue Ruling 82-20 and Exam-

ple 5 of the Consolidated Return Regulations are not inconsistent because they address different situations").

The secondary issue petitioner identifies—the standard of review that courts of appeals should apply when reviewing a Tax Court decision (Pet. 8-13)—was correctly decided by the court of appeals and does not implicate a meaningful conflict among the circuits.

a. The applicable standard of review is clearly defined in Section 7482(a)(1) of the Internal Revenue Code (26 U.S.C.):

> The United States Courts of Appeals * * * shall have exclusive jurisdiction to review the decisions of the Tax Court * * * in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury.

Petitioner thus errs in asserting that "the Tax Court is due some level of respect beyond that of a district court." Pet. 10. Section 7482(a)(1) plainly bars such heightened "respect" by mandating that courts of appeals review Tax Court decisions "in the *same* manner" and "to the *same* extent" as district court decisions. 26 U.S.C. 7482(a)(1) (emphasis supplied). Indeed, this Court long ago noted that the very "purpose" of Section 7482 was "to remove from the law the favored position (in comparison with District Court and Court of Claims rulings in tax matters) [previously] enjoyed by the Tax Court." *Commissioner* v. *Duberstein*, 363 U.S. 278, 291 n.13 (1960).

b. Contrary to petitioners' claim (Pet. 10-11), the Second, Third, Fifth, Sixth, Seventh, Eleventh, and D.C. Circuits consistently review Tax Court decisions de novo, although they employ varying verbal formula-

tions in doing so.* While the Ninth Circuit has observed that Tax Court opinions may be "entitled to respect because of its special expertise in the field," *Magneson* v. *Commissioner*, 753 F.2d 1490, 1493 (9th Cir. 1985), more recent decisions from that Circuit confirm that it conducts a de novo review. See *Graham* v. *Commissioner*, 822 F.2d 844, 848 (9th Cir. 1987). That court, indeed, has observed that "[t]he frequent recitations of special deference are apparently mutations that this court has ignored when we disagree with the Tax Court. * * * To the extent that expressions of deference in reviewing questions of law are harmless honorifics among fellow judges, they waste ink. To the extent that they sow confusion, they are best ignored." *Vukasovich, Inc.* v. *Commissioner*, 790 F.2d 1409, 1413 (9th Cir. 1986). See *Best Life Assurance Co.* v. *Commissioner*, 281 F.3d 828, 830 (9th Cir. 2002) ("[W]e give no special deference to the Tax Court's decisions."); *Custom Chrome, Inc.* v. *Commissioner*, 217 F.3d 1117, 1121 (9th Cir. 2000) (same); *AMERCO, Inc.* v. *Commissioner*, 979 F.2d 162, 164 (9th Cir. 1992) (same). In any event, to the extent the Ninth Circuit's precedent may not be entirely uniform on this subject, a

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* *Madison Recycling Assocs.* v. *Commissioner*, 295 F.3d 280, 285 (2d Cir. 2002) (no deference); *Geisinger Health Plan* v. *Commissioner*, 985 F.2d 1210, 1212 (3d Cir. 1993) (review plenary); *ABKCO Indus., Inc.* v. *Commissioner*, 482 F.2d 150, 155 (3d Cir. 1973) (same); *Yarbro* v. *Commissioner*, 737 F.2d 479, 483 (5th Cir. 1984) (independent analysis); *Horton* v. *Commissioner*, 33 F.3d 625, 627 (6th Cir. 1994) (de novo review); *Smith* v. *Commissioner*, 926 F.2d 1470, 1474 (6th Cir. 1991) (same); *Hackl* v. *Commissioner*, 335 F.3d 664, 666 (7th Cir. 2003) (no special deference); *Exacto Spring Corp.* v. *Commissioner*, 196 F.3d 833, 838 (7th Cir. 1999) (same); *Estate of Caporella* v. *Commissioner*, 817 F.2d 706, 708 (11th Cir. 1987) (de novo review); *InverWorld, Ltd.* v. *Commissioner*, 979 F.2d 868, 875-876 (D.C. Cir. 1992) (de novo review).

conflict among decisions of the same court of appeals is a matter properly resolved by that court. *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) ("It is primarily the task of a Court of Appeals to reconcile its internal difficulties.").

3. Review is also unwarranted in this case because resolution of the question presented would not affect the judgment below. The court of appeals' decision is supported by an alternative ground that the petition does not appear to challenge, namely the court's determination that the "step transaction doctrine" is applicable in this case. Pet. App. 15a-18a. Thus, the result would be the same even under petitioner's newly asserted view of the law.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

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AEROQUIP-VICKERS, INC., AND SUBSIDIARIES,
f/k/a Trinova Corporation and Subsidiaries
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Sixth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Petitioners, Aeroquip-Vickers, Inc., and subsidiaries, submit this reply brief in support of the petition for a writ of certiorari, addressing solely the new points raised in the brief in opposition filed by Respondent, Commissioner of Internal Revenue.

Introduction

As is understandable in papers opposing petitions for certiorari, Respondent's brief is designed to narrow the issue presented and obscure the broader significance of this case. Agency efforts to disguise *de facto* amendments to their regulations issued after notice and comment by issuing "rulings" or informal interpretations that extend beyond the fair import of the regulatory language is a phenomenon troubling the courts of appeals and commentators across a wide range of administrative agencies. It is not limited to the Commissioner of Internal Revenue. The availability in this case of an expert assessment of what meanings the regulatory language could bear, as opposed to the Commissioner's self-interested creation (an "interpretation") of a step-transaction approach missing from the regulation he purports to interpret, provides the Court with a particularly helpful context from which to address this problem.

Moreover, this case offers the Court a second opportunity in the coming Term to address the important question of the authority of the Tax Court, a court of national jurisdiction, in the context of 26 U.S.C. §7482 (I.R.C.). In April 2004, the Court granted certiorari in two cases, now consolidated, *Estate of Kanter v. Commissioner*, 337 F.3d 833 (7th Cir. 2003), *cert. granted*, 72 U.S.L.W. 3672 (U.S. Apr. 26, 2004) (No. 03-1034), and *Ballard v. Commissioner*, 321 F.3d 1037 (11th Cir. 2003), *cert. granted*, 72 U.S.L.W. 3672 (U.S. Apr. 26, 2004) (No. 03-184). Among the questions presented in these cases, which address the Tax Court's

ability to prevent the findings of facts and law of Special Trial Judges from being disclosed to taxpayers, is "[w]hether this secretive process is consistent with 26 U.S.C. §7482, which provides that Article III courts must review Tax Court decisions just as they would decisions of a U.S. district court[.]" *Ballard,* 72 U.S.L.W. 3672 (U.S. Apr. 26, 2004) (No. 03-184). This case similarly presents an opportunity for the Court to define the boundaries of the jurisdictional mandates established in section 7482 and to do so in the context of a regulatory-interpretation predicament that cuts across all administrative agencies.

Discussion

I. Section 7482(c)(1) and Its Proper Application by Courts of Appeals Is the Cause for this Petition.

Respondent's opposition to this petition for a writ of certiorari turns ultimately on a re-interpretation of the issue presented. As Respondent describes it, the issue is simply the appropriate standard of review a circuit court should apply to Tax Court decisions on questions of law. Gov't 5. Respondent then maintains that Petitioners failed to raise that issue below and should not be permitted to do so here. Gov't 5-6.

Respondent misconstrues – or simply sidesteps – the actual issue presented by the petition.

A. The Issue Is How Courts of Appeals Must Discharge their Responsibilities to Determine that Tax Court Decisions Are "In Accordance with Law" under Section 7482(c)(1).

Despite the Respondent's re-framing, the issue is not whether a circuit court, when reviewing a Tax Court decision, should consider questions of law-application "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury," *i.e.*, *de novo*, under I.R.C. §7482(a)(1). There is no dispute that it must. Gov't 6; Pet. C.A. Br. 16; Gov't C.A. Br. 26. The actual issue

presented is more difficult – and more in need of this Court's guidance: when the Tax Court interprets a notice-and-comment regulation and decides that an informal ruling issued by the Commissioner of Internal Revenue is inconsistent with it, how must a circuit court decide that the Tax Court's decision is not "in accordance with law" under I.R.C. §7482(c)(1) before overruling it. *See* Pet. 9-10.

Respondent failed to reference I.R.C. §7482(c)(1) – in any manner – in the brief in opposition.

Although relying entirely on I.R.C. §7482(a)(1), Respondent ignores the implication of a standard of review for the Tax Court comparable to that of a district court "tried without a jury." For questions of law *simpliciter*, there is no difference in courts of appeals' review of district court judgments – whether reached with or without a jury. Congress's use of the limiting formula of "tried without a jury" thus shows that section 7482(a)(1) addresses review of Tax Court determinations of questions of fact and of law-application, overturning this Court's decision in *Dobson v. Commissioner*, 320 U.S. 489 (1943). It is section 7482(c)(1) that sets the responsibility of the court of appeals as to questions of law alone. As discussed in the petition (Pet. 12), this Court has not ruled on the meaning of section 7482(c)(1) in light of Congress's amendment to section 7482(a)(1).

To comply with its obligations under I.R.C. §7482, therefore, the Sixth Circuit was required to analyze the Tax Court's judgment under both I.R.C. §7482(a)(1) and I.R.C. §7482(c)(1). It is this tension between sections 7482(a)(1) and 7482(c)(1) that gives rise to this petition. Pet. 9-13.

The Sixth Circuit, like the Respondent here, failed to address – in any manner – the Tax Court's judgment under section 7482(c)(1).

B. The Issue Presented in this Petition Arose upon the Sixth Circuit Improperly Deferring to the Commissioner's Informal Ruling over the Tax Court's Fully Reviewed, Effectively En Banc, Decision.

Respondent states that this petition need not be considered, because the Petitioners have not disputed the *de novo* standard of review, which is, as Respondent maintains, the issue. Gov't 6. While Respondent is correct that Petitioners have not disputed the propriety of the *de novo* standard, the issue arose solely from the Sixth Circuit's own failure to fulfill its jurisdictional mandate. It was not presented to the Sixth Circuit because it arose from the Sixth Circuit's decision.

The Tax Court determined that the Commissioner's informal ruling did not comport with the language of the notice-and-comment regulation. What Petitioners could not have anticipated was that, in considering the Tax Court's judgment, the Sixth Circuit would ignore the restraints on its own authority that section 7482(c)(1) commands. The Sixth Circuit having further failed to correct its interpretative mistakes following a petition for rehearing and rehearing *en banc*, the need for this Court's review became apparent. Because of the Sixth Circuit's decision, and its neglect of section 7482(c)(1), the issue remains appropriate for review – even if raised for the first time. "An issue is not lost if it could not have been considered, or was raised and not considered, on an earlier appeal." CHARLES A. WRIGHT, ARTHUR R. MILLER, AND EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4478.6 (2d ed. 2002). *Cf. United States v. Speers*, 382 U.S. 266, 278 n.22 (1965) ("The §67b argument raised in this Court differs from that rejected below . . . . Insofar as it is relevant to the particular problem of statutory construction presented by this case, we regard the §67b argument as properly before us."). Moreover, section 7482 is a jurisdictional statute. Issues concerning the courts of appeals' exercise of jurisdiction and the powers inherent

may be raised at any time, as this Court has long recognized. *See, e.g., City of Gainesville v. Brown-Crummer Investment Co.*, 277 U.S. 54, 59 (1928).

At bottom, the question here concerns competition between the view of the Commissioner and the view of the Tax Court on a simple question of law, not any difference between review of a district court and review of the Tax Court. The Sixth Circuit deferred to the Commissioner's informal interpretation of a notice-and-comment regulation. It gave no deference to the Tax Court, a court of specialized expertise, which found that the possible interpretations of the regulation's language did not include that posited by the Commissioner, a "party to this dispute." Pet. App. 19a. Like the determinations courts make in applying the first step in analysis under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the question whether regulatory language permits a purported interpretation is a simple question of law – the responsibility of a court (here, initially, the Tax Court) and not an agency (here, the Commissioner). *See id.* at 2781, n. 9. To prefer the Commissioner's informal interpretation over the Tax Court's at *Chevron* "step one" is to deny this proposition. This error allows agencies to undermine the normal public procedures for notice-and-comment rulemaking by effectively amending their regulations through informal interpretations that are wholly outside the language of the regulation being interpreted. This, they may not do. *See, e.g., Central Laborers' Pension Fund v. Heinz*, 124 S. Ct. 2230, 2238 (2004) ("[n]either an unreasoned statement in the [Internal Revenue] manual nor allegedly longstanding agency practice can trump a formal regulation with the procedural history necessary to take on the force of law."); *United Dominion Indus. v. United States*, 532 U.S. 822, 838 (2001) ("[t]o the extent the Government disagrees [with the approach of the consolidated return regulations], it may amend its regulations to provide for a different one.").

Providing appellate courts with appropriate direction in these circumstances is particularly opportune. For the Tax Court, as noted in the petition, this is underscored by two trends: the increasing percentage of tax cases heard in the Tax Court (Pet. 13-14); and the increasing amount of informal guidance issued by the Commissioner relative to regulations (Pet. 15 –16). By considering this petition, the Court has the opportunity to provide the needed analytical tools for appellate courts to fulfill their obligations when reviewing Tax Court decisions. And it will also provide the Court the opportunity to address the ever-increasing trend in the administrative law arena of agencies that seek to avoid the rulemaking procedures by relying on spurious interpretations in lieu of simply amending their regulations in the first instance.

II. The Tax Court's Rejection of the Step-Transaction Doctrine, and Its Holding that Rev. Rul. 82-20 Was Inconsistent with the Legislative Regulations, Was "In Accordance with Law."

Respondent also states that the Sixth Circuit's judgment is supported by an alternative ground that does not implicate the Sixth Circuit's preference for the Commissioner's informal ruling over the Tax Court's analysis, namely the "step-transaction" doctrine. Gov't 9. The step-transaction doctrine is, however, the sole basis of the Commissioner's informal ruling, and its applicability is undermined not only by the undisputed, stipulated facts, but also by the legislative regulation *per se*. The Sixth Circuit's misapplication of the step-transaction doctrine highlights its failure to apply the necessary rigor to the Tax Court's analysis under I.R.C. §7482(c)(1).

A. Revenue Ruling 82-20 Expressly Relies on the Step-Transaction Doctrine.

The step-transaction doctrine is not a separate basis for the Sixth Circuit's decision. The Commissioner's informal interpretation of 26 C.F.R. § 1.1502-3(f)(2) (Treas. Reg.) in Rev. Rul. 82-20 does not rely on anything *other than* the step-transaction doctrine.

> When there is no intention at the time of transfer to keep the property within the consolidated group, the transaction should be viewed as a *whole* and not as separate *individual* transactions. . . . Because the transfer [of the section 38 property] from P to S is a *step* in the planned transfer of the property outside the group, [the exception in] section 1.1502-3(f)(2)(i) of the regulations does not apply [to this transaction]. . . . Therefore, the transfer from P to S is a disposition under section 47(a)(1).

Rev. Rul. 82-20, 1982-1 C.B. 6, 7 (emphasis added). The step-transaction doctrine underlies Rev. Rul. 82-20 in the first place; it is the only basis for the Sixth Circuit's decision.

B. The Commissioner Stipulated to the Facts that Make the Step-Transaction Doctrine Immaterial.

The Respondent neglects to mention that the Respondent stipulated to the facts that make the application of the step-transaction doctrine immaterial. Indeed, the Sixth Circuit panel-majority's finding that the step-transaction doctrine may still apply required a determination that the Tax Court's decision was clearly erroneous; the Sixth Circuit provided no justification for any such holding.

In the Tax Court, the Commissioner stipulated to the propriety of the Petitioners' corporate reorganization under I.R.C. §§368(a)(1)(D) and 355. Pet. App. 44a. The Commissioner thus conceded, *inter alia*, that the reorganization was "not used principally as a device for the distribution of the earnings and profits" of Libbey-Owens-

Ford or of LOF Glass.[1] *See* I.R.C. §355(a)(l)(B). The Commissioner admitted that Libbey-Owens-Ford and LOF Glass were engaged in the "active conduct of a trade or business" both before and after the transaction. *See* I.R.C. §§ 355(a), (b). As Judge Tannenwald stated for the Tax Court, "[b]y so doing, respondent has stipulated that there was a business purpose, *i.e.*, substance, to the transfer by petitioner to LOF Glass, Inc., a position which is inconsistent with her position herein that petitioner disposed of the assets by in effect transferring them to Pilkington Holdings." Pet. App. 54a.

Having stipulated to the propriety not only of each step but also of the entire reorganization and split-off, the Commissioner by necessity stipulated to the reorganization's overall substance and legality. The Commissioner cannot now claim, nor was it supportable for the Sixth Circuit to hold, that, for investment tax credit purposes alone, the transaction should be ignored. If the Petitioners' corporate transfers had real and economic viability and thus were not merely tax-avoidance transactions, then all aspects of the reorganization must stand.

A prerequisite for the step-transaction doctrine is a tax avoidance motive. *See, e.g., Gregory v. Helvering*, 293 U.S. 465 (1935). As part of his detailed analysis of the panel-majority's misapplication of the step-transaction doctrine, the dissenting Sixth Circuit judge noted the panel-majority's inherent illogic:

> I have no idea how a party could possibly intend several steps to achieve various legitimate business purposes but simultaneously intend the *series* of

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[1] As described in the petition, Aeroquip-Vickers, Inc., operating as the Libbey-Owens-Ford Company at the time ("LOF"), transferred its glass manufacturing division to a wholly owned subsidiary, LOF Glass, Inc. ("LOF Glass"), in 1986. Approximately two months later, LOF transferred all of the stock of LOF Glass to one of LOF's shareholders, Pilkington Holdings ("Pilkington"), in exchange for Pilkington's shares in LOF.

> steps to accomplish an illegitimate tax-avoidance objective.

Pet. App. 38a (J. Clay, dissenting) (emphasis in original).

C. Rev. Rul. 82-20 Is Directly Contrary to the Legislative Regulations It Purports to Interpret.

In determining the acceptable range of interpretations of Treas. Reg. § 1.1502-3(f)(2)(i) and its examples, the Tax Court concluded that the language of these legislative regulations was clear, holding that, first, when property for which a taxpayer obtained an investment tax credit ("ITC") (known as "section 38 property") is transferred to a member of its consolidated tax group, then the transfer itself does not trigger an obligation to repay or "recapture" the ITCs. Second, it is the "transferee" that assumes the obligation to repay the ITCs in connection with the section 38 property, and it is only when the transferee disposes of the section 38 property or ceases to use it in its business that it may be liable for the ITC recapture. The **transferor** has no further obligations with respect to the section 38 property. And, third, when the stock of the transferee is subsequently transferred, no ITCs must be repaid. Pet. App. 47a - 48a.

The Commissioner argued, and the panel-majority below agreed, that Rev. Rul. 82-20 limits the application of Treas. Reg. § 1.1502-3(f)(2)(i), despite being a "legislative" regulation issued after notice and comment. *See Wolter Construction Co. v. Commissioner*, 634 F.2d 1029, 1032 (6th Cir. 1980); *see also United Dominion*, 532 U.S. 822 (2001). Under Rev. Rul 82-20, these regulations are applicable only when the parties transfer the section 38 property with an intent to keep the property within the consolidated group for some period of time, minimally one tax year. Rev. Rul. 82-20, 1982-1 C.B. 6. Thus, in this case, dispensing with the Tax Court's analysis, the Commissioner and the panel-majority imposed an obligation on the **transferor** – not the **transferee** – to repay the ITCs.

The rub, as the Tax Court's analysis confirmed, is that there is nothing in the regulation that imposes an "intent" requirement. There is no "timing" requirement. There is no "integrated-" or step-transaction-analysis requirement. Where the notice-and-comment regulation imposes liability on the transferee, the Commissioner's informal interpretation imposes it on the transferor. In short, the Commissioner's informal ruling shifts the ITC repayment obligation to the wrong taxpayer. The Tax Court rightly found Rev. Rul. 82-20 to be excluded from the realm of interpretive possibilities of the language of the Treasury regulation. Its analysis was therefore "in accordance with law" under section 7482(c)(1).

CONCLUSION

For the reasons stated in the petition for a writ of certiorari and this reply brief, the petition should be granted

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